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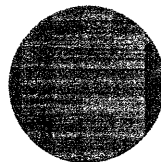
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**DOES OWNERSHIP MATTER?**

**ASIA AND THE GLOBAL OPERATIONS OF  
MULTINATIONAL CORPORATIONS**

**Dennis Encarnation**

**MITJP 96-01**

Center for International Studies  
Massachusetts Institute of Technology

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*E38-754*  
*Center for International Studies*  
*77 Massachusetts Avenue, Cambridge, MA 02139*

**Tel: 617-253-2839**  
**Fax: 617-258-7432**  
**Email: <robart@mit.edu>**

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## Abstract

### **DOES OWNERSHIP MATTER? ASIA AND THE GLOBAL OPERATIONS OF MULTINATIONAL CORPORATIONS**

[Dennis J. Encarnation]

Today, Asia (outside of Japan) is the principal host to foreign direct investment (FDI) destined for newly-industrializing economies. And when compared to more industrialized countries, Asia now ranks behind North America and Western Europe, which continue to account for the lions' share of both existing stocks and new flows of FDI. But Asia's leading status, even among newly-industrializing economies, is quite new: Just a decade ago, in 1985, FDI flows to Latin America still outpaced comparable flows to Asia, leaving accumulated stocks in that region well below FDI found elsewhere. But subsequently, FDI flows to Asia accelerated rapidly, especially during the 1990s, when they jumped well beyond levels recorded in any other developing region.

Within Asia, most of this FDI is concentrated in a very few economies, and comes from a very few sources. Today, just three hosts--Hong Kong, Indonesia, Singapore--account for over one-half of all accumulated stocks originating in either the United States or Japan, still the two largest national sources of FDI into Asia. Shifting from stocks to flows, just one host--China--accounts today for over one-half of all new FDI in Asia. But China's leading status is quite new: As recently as 1990, Singapore received more FDI inflows than did China. Subsequently, however, FDI to China skyrocketed, accounting for nearly half of all Asian inflows. Leading this recent surge are Asian investors, from Korea and especially the Chinese communities located in Hong Kong, Taiwan, and across ASEAN. During the 1990s, these regional investors easily surpassed both the Americans and the Japanese as Asia's leading sources of FDI.

Much of that FDI is now integral to the Asian operations of multinational corporations (MNCs) based in the United States, Japan, and elsewhere in Asia. Over time, these operations have begun to converge despite obvious differences among MNCs in their geographic and historical origins. Such convergence has at times been even more pronounced in Asia than elsewhere in the world, as demonstrated by the common geographic and industrial concentration of FDI from various sources. More often, MNCs in Asia more closely mimic patterns of convergence apparent elsewhere, as they do in the pursuit of majority shareholdings and FDI-generated sales. Yet important differences in MNC operations persist, even in the same location and industry. In home-country sourcing and intra-firm trade, for example, MNCs in Asia differ much like they do elsewhere in the world. Such differences may even be more pronounced in Asia than elsewhere, as demonstrated by wide variation in host-market and export sales. Taken together, then, the regional operations of multinational corporations in Asia confirm the persistence of important operational differences, while also reaffirming that these same multinationals are moving along an otherwise common evolutionary path.

When combined, these emerging similarities and persistent differences have important implications for both corporate strategy and government policy. For example, sharp differences can still be discerned between multinationals in their determination of markets for outputs, sources for inputs, and the organization of that trade between markets (arm's-length transactions) and hierarchies (intra-firm transactions). Just as the relationship between FDI and trade varies significantly among multinational corporations, so too that relationship also varies among national economies. Bounded in absolute value by more macro-economic determinants, FDI can contribute proportionately to that trade, while also altering its composition and direction--not only for individual multinationals, but also for host (and home) economies. Simultaneously, such trade can have a significant impact on the value, direction, and composition of FDI, again at both the micro-level of multinationals and the macro-level of national economies. These complementarities between FDI and trade have important policy consequences: Cross-national differences in trade and FDI regimes can explain much of the wide variation in the relative contribution of multinationals to host-country exports and imports across Asia.

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Within Asia, as we shall see below, most of this FDI is concentrated in a very few economies, and comes from a very few sources. Today, just three hosts--Hong Kong, Indonesia, Singapore--account for over one-half of all accumulated stocks originating in either the United States or Japan, still the two largest national sources of FDI in Asia. Shifting from stocks to flows, just one host--China--accounts today for over one-half of all new FDI in Asia. But China's leading status is quite new: As recently as 1990, Singapore received more FDI inflows than did China. Subsequently, however, FDI to China skyrocketed, accounting for nearly half of all Asian inflows. Leading this recent surge are Asian investors, from Korea and especially the Chinese communities located in Hong Kong, Taiwan, and across ASEAN. During the 1990s, these regional investors surpassed both the Americans and the Japanese as Asia's leading sources of FDI flows.

Much of that FDI is now integral to the Asian operations of multinational corporations (MNCs) based in the United States, Japan, Korea, and elsewhere in Asia. Over time, as documented in great detail below, these operations have begun to converge despite obvious differences among MNCs in their geographic and historical origins. Such convergence has at times been even more pronounced in Asia than elsewhere in the

world, as demonstrated by the common geographic and industrial concentration of FDI from various sources. More often, MNCs in Asia more closely mimic patterns of convergence apparent elsewhere, as they do in the pursuit of majority shareholdings and FDI-generated sales. Yet important differences in MNC operations persist, even in the same location and industry. In home-country sourcing and intra-firm trade, for example, MNCs in Asia differ much like they do elsewhere in the world. Such differences may even be more pronounced in Asia than elsewhere, as demonstrated by wide variation in host-market and export sales. Taken together, then, the regional operations of multinational corporations in Asia confirm the persistence of important operational differences, while also reaffirming that these same multinationals are moving along an otherwise common evolutionary path.

When combined, these emerging similarities and persistent differences have important implications for both corporate strategy and government policy, implications explored in the concluding section of this paper. As we shall see, sharp differences can still be discerned between multinationals in their determination of markets for outputs, sources for inputs, and the organization of that trade between markets (arm's-length transactions) and hierarchies (intra-firm transactions). Just as the relationship between FDI and trade varies significantly among multinational corporations, so too that relationship also varies among national economies. Bounded in absolute value by more macro-economic determinants, FDI can contribute proportionately to that trade, while also altering its composition and direction--not only for individual multinationals, but also for host (and home) economies. Simultaneously, such trade can have a significant impact on the value, direction, and composition of FDI, again at both the micro-level of multinationals and the macro-level of national economies. These complementarities between FDI and trade have important policy consequences: Cross-national differences in trade and FDI regimes can explain much of the wide variation in the relative contribution of multinationals to host-country exports and imports across Asia.

Beginning with a broad survey of FDI sources and destinations, this paper moves to examine in greater detail the regional operations of multinationals making that investment, before concluding with an assessment of the broad implication of these several findings for both corporate strategy and government policy.

## **FDI SOURCES AND DESTINATIONS**

The two largest national sources of FDI in Asia are Japan and the United States. By 1993 (the most recent year for which comparable data are available, and reported in Table 1) American and Japanese multinationals each contributed roughly one-sixth (between 15 and 17 percent) of all FDI flows into newly-industrializing Asia--a share that rises to one-quarter of all FDI flowing into Asia outside of China. By contrast, according to the best available estimates, European multinationals probably contributed no more than 10 percent of Asia's FDI inflows<sup>2</sup>--less than one-half the relative contribution of either American or Japanese multinationals. The remainder, contributing well over two-thirds of all FDI flows into Asia (and over four-fifths of all FDI flows into China), came from other, principally Asian investors largely based in the newly-industrializing economies of Hong Kong, Korea, and Taiwan.

-- INSERT TABLE 1 HERE --

### **US and Japanese FDI**

Historically, American multinationals have long concentrated most of their foreign direct investment outside of Asia, in North and South America, as well as in Western Europe--in marked contrast to the Japanese, who have long placed a far greater emphasis on their Asian neighbors. Prior to the Second World War, Asia attracted the lion's share (over three-quarters, by one estimate<sup>3</sup>) of all Japanese direct investments

**TABLE 1****FOREIGN DIRECT INVESTMENT (FDI) FLOWS  
INTO ASIA, BY DESTINATION AND SOURCE, 1993****ASIA INCLUDING CHINA (\$ billion)** \_\_\_\_\_

"Greater China," of which:	
China	\$27.5
less "round-tripping" <sup>a</sup>	-\$10.0
estimated FDI in China	=\$17.5
Hong Kong <sup>b</sup>	\$1.7
Taiwan	\$0.9
Other East Asia <sup>c</sup>	\$17.2
of which: Singapore	\$6.8
South Asia	\$1.1
Total FDI Flows into Asia <sup>d</sup>	\$38.4
of which:	
US FDI	\$5.8
Japanese FDI	\$6.6
Korean, Chinese, Other	\$26.0

**ASIA EXCLUDING CHINA (\$ billion)** \_\_\_\_\_

"Three Dragons," of which:	
Singapore	\$ 6.8
Hong Kong <sup>b</sup>	\$1.7
Taiwan	\$0.9
Other East Asia <sup>c</sup>	\$10.4
South Asia	\$1.1
Total FDI Flows into Asia <sup>d</sup>	\$20.9
of which:	
US FDI	\$5.2
Japanese FDI	\$4.9
Korean, Chinese, Other	\$10.8

**Notes:** <sup>a</sup>Domestic Chinese investment temporarily recycled principally through Hong Kong in order to receive foreign-investment incentives upon reentry into China.

<sup>b</sup>Includes only FDI from OECD member countries.

<sup>c</sup>Excludes Japan.

<sup>d</sup>Excludes Western Asia and former Soviet Central Asian Republics.

**Sources:** IMF Balance of Payments Statistics and World Bank estimates, May 1995, UNCTAD estimates, July 1995.

abroad; while for the Americans, the comparable Asian share was minuscule (probably under 5 percent<sup>4</sup>), less than any other region of the world except Africa. After the war, that Asian share actually declined for the Americans, leveling out to roughly 3 percent, where it stayed well into the 1970s. Meanwhile, most Japanese investments in Asia were nationalized by their host countries after the war, and new FDI outflows were reduced to a trickle, as capital controls at home and lingering animosities abroad nearly eradicated the prewar investments of Japanese corporations in Asia.

But during the 1970s and (especially) the 1980s, both Japanese and American multinationals would greatly accelerate their new investments in Asia. At least for the Americans, that growth greatly outpaced increases elsewhere, leading Asia to nearly double its share of U.S. FDI, from less than 4 percent as recently as 1977,<sup>5</sup> to nearly 8 percent by 1994 (calculated from Table 2). That growth actually catapulted Asia past South America as the leading site for U.S. FDI among emerging markets. For the Japanese, however, Asia consistently ranked much higher, among the top two or three destinations for their FDI: By 1994, Asia had come to account for 16 percent of all approved Japanese FDI worldwide--comparable to Western Europe (see Table 2), but well behind North America and comparable figures before the war.

-- INSERT TABLE 2 HERE --

While American and Japanese multinationals continue to differ in terms of the relative importance they assign Asia as a desirable destination for their FDI, they both have long concentrated their different Asian investments in a very few host countries. Before the war, for example, China, the Philippines, and the Netherlands East Indies (later, Indonesia) each hosted more U.S. FDI than did Japan.<sup>6</sup> Among these, the United States long harbored colonial ambitions in China's large domestic market, while the Philippines had become a U.S. territory, one blessed with plentiful natural resources,

**TABLE 2**

**ACCUMULATED STOCKS OF FOREIGN DIRECT INVESTMENT (FDI) BY AMERICAN AND JAPANESE MULTINATIONALS (MNCs), 1994**

<u>AMERICAN MNCs ABROAD, 1994<sup>a</sup></u>		<u>JAPANESE MNCs ABROAD, 1994<sup>b</sup></u>	
Location of FDI	<u>1994 (\$ bil.)</u>	Location of FDI	<u>1994 (\$ bil.)</u>
Worldwide	\$612.1	Worldwide	\$463.6
North America	\$89.2	North America	\$202.7
Western Europe	\$300.2	Western Europe	\$89.9
Japan	\$37.0		
Other East Asia	\$47.3	East Asia	\$76.2
of which:	<u>% of East Asia</u>	of which:	<u>% of East Asia</u>
<u>Four NIEs</u>		<u>Four NIEs</u>	
Korea	7.6%	Korea	7.0%
Taiwan	8.2%	Taiwan	5.2%
Hong Kong	25.3%	Hong Kong	18.2%
Singapore	23.2%	Singapore	12.5%
<u>ASEAN Four</u>		<u>ASEAN Four</u>	
Thailand	8.0%	Thailand	9.4%
Malaysia	5.0%	Malaysia	8.4%
Indonesia	10.6%	Indonesia	22.3%
Philippines	5.0%	Philippines	3.7%
<u>Big Two</u>		<u>Big Two</u>	
India	1.7%	India	0.6%
China	3.6%	China	11.4%
of which:	<u>% of East Asia</u>	of which:	<u>% of East Asia<sup>c</sup></u>
<u>Manufacturing</u>	34.8%	<u>Manufacturing</u>	43.2%
Chemicals	5.9%	Textiles	3.8%
Electronics	11.8%	Electronics	10.1%
<u>All Other</u>	65.2%	<u>All Other</u>	66.8%
Petroleum	20.7%	Mining	12.2%
Wholesaling	16.3%	Wholesaling	9.1%
Finance	20.9%	Finance	10.2%

**Notes:** <sup>a</sup>Historical-costs basis.

<sup>b</sup>Approval basis.

<sup>c</sup>1993 data.

**Sources:** United States, Department of Commerce, 1994, pp. 88-124; 1986, Table 1, pp. 1-5; 1982, Table 1, pp. 1-27; Japan, Ministry of Finance, 1994, n.p.

many of which also became available in greater abundance in the Netherlands East Indies. Colonization had an even stronger impact on the Japanese: On the eve of the war, China (especially Manchuria) hosted the lion's share of all Japanese FDI worldwide, followed by Korea and Taiwan. After the war, however, the Japanese were excluded from most of their former colonial possessions, while the Americans remained concentrated in the Philippines which, along with India, accounted for over one-half of all U.S. FDI in Asia as late as 1966.<sup>7</sup> Through the 1960s, host governments in the Philippines, India, and elsewhere across the region had erected steep trade barriers which (as we shall see below) induced a few prospective U.S. exporters to invest in foreign manufacturing in order to supply protected local markets.

Subsequently, however, the principal incentives for foreign direct investment in Asia shifted dramatically, as did the geographic concentration of that investment. As a result, by the 1994, three economies--Hong Kong, Indonesia, and Singapore--accounted for well over one-half of all the FDI located in Asia by either American or Japanese multinationals. For sure, they differed in their rank-ordering of these three hosts. Hong Kong and Singapore accounted for roughly one-half of all U.S. FDI in Asia outside of Japan, with Indonesia leading a third tier of host countries. For the Japanese, Indonesia retained its historical lead, but its relative share had nearly been cut in half during the 1980s,<sup>8</sup> leaving it by 1994 with less than one-quarter of all Japanese FDI in Asia (see Table 2). Fast approaching, growing during the 1980s at twice the rate recorded in Asia as a whole, were Hong Kong and Singapore, both of which had raced past Korea on the way to ranking second and third (respectively) among Asian hosts to Japanese FDI.

By concentrating their FDI in these three countries, American and Japanese multinationals followed comparable strategies. For both, Hong Kong bolstered its position as the regional center for distribution, finance, and other trade-related service (all increasingly directed at China); Indonesia remained the Asian center for petroleum, mining, and other extractive industries; Singapore emerged as a regional center for

manufacturing, especially of electronics. Thus, across these three countries, a similar pattern of national specialization has attracted both American and Japanese multinationals.

The Americans, at least, have contributed to such national specialization by concentrating their Asian operations in a very few countries, where they have invested in a very few economic sectors (see Table 2). Simply put, American multinationals in Asia engage in a narrower range of extractive, manufacturing, and service industries than they do elsewhere in the world. Petroleum, for example, contributes twice the proportion of U.S. FDI in Asia that it does elsewhere in the world, even though its share has recently begun to decline.<sup>9</sup> Moreover, the ever-growing share of U.S. FDI invested in Asian wholesaling is also much higher than in other regions. Only manufacturing attracts shares of U.S. FDI comparable to those elsewhere; yet even here, those shares have been growing in Asia while they have been declining worldwide. And within manufacturing, U.S. FDI in the electronics industry stands out for its greater concentration in Asia (12 percent of all U.S. FDI in Asia versus 3 percent of all U.S. FDI worldwide<sup>10</sup>). By comparison, U.S. FDI in chemicals stands out for its limited presence in Asia, especially since it is the largest source of U.S. FDI in manufacturing worldwide. But this is a recent pattern: For as recently as 1977, what little U.S. FDI entered Asian manufacturing was more likely to produce chemicals and not electronics.<sup>11</sup> In short, the surge of U.S. FDI into Asian electronics is quite recent, having principally occurred during the 1980s, reflecting that region's growing specialization in electronics.

Compared to the Americans, Japanese multinationals are more widely dispersed both sectorally and geographically. In Asian manufacturing, for example, Japanese multinationals have become even more diversified than their American counterparts, with far more investment spread out across numerous sectors and several countries. To illustrate: While electronics attracts much FDI in Asia, that industry nevertheless accounts for a smaller proportion of Japanese investment across the region than it does

for the Americans (see Table 2). Alternatively, textiles attracts a much higher proportion of Japanese FDI in the region--not just because U.S. FDI in that sector is virtually nonexistent, but also because textiles was the leading recipient of Japanese FDI in Asian manufacturing up until the 1980s, when American and then Japanese FDI in Asian electronics took-off. Such growth in Japanese FDI has actually increased the geographic spread of Japanese investments in Asian manufacturing. Indeed, the second tier of Asian hosts (especially China and Thailand) is rapidly approaching the first tier as principal destinations for Japanese FDI. And with that growth, the Asian investments of Japanese multinationals are becoming ever-more diffused across countries and industries--moving in a direction opposite that of the Americans.

While both American and Japanese multinationals have come to concentrate a sizable--at least in recent years, growing-- share of their FDI in Asia, European multinationals have not. Indeed, according to the best estimates available, Asia actually accounts for a small and declining share of the worldwide FDI of multinationals based in the European Union.<sup>12</sup> As a result, European multinationals probably contributed no more than 10 percent of Asia's FDI inflows--less than one-half the relative contribution of either American or Japanese multinationals. And this European contribution was minuscule compared to large and growing levels of intra-regional FDI from Asia's newly industrializing economies. For in addition to Japan, the principal sources of intra-regional FDI in Asia are either Korea or the largely ethnic Chinese sources of Hong Kong, Singapore, and Taiwan.

## **Korean and Ethnic Chinese FDI**

By 1993, Korean multinationals had concentrated their modest foreign direct investments (stocks) in the Pacific Basin, roughly balanced between North America (mainly the United States) and Asia, with each region accounting for nearly 40 percent of all Korean FDI.<sup>13</sup> Of the remaining 20 percent, one-half was located in Western Europe. By sector, manufacturing accounted for over two-fifths of all Korean FDI worldwide, with much of this engaged in the production of basic and fabricated metals. Much of the remaining Korean FDI was engaged in wholesale (and retail) trade, followed by the processing of petroleum and other natural resources. But the geographic location of these sectoral investments varies widely across critical markets and sources of supply. Of these, three--the United States, Indonesia, and China--accounted for well over one-half all Korean FDI worldwide. And they illustrated the broad range of investment strategies adopted by Korean multinationals.

The United States has long been the single largest host for Korean direct investments, accounting in 1993 for nearly one-third of total stocks. Existing trade patterns help explain this concentration of Korean FDI: The United States is also the single largest market for Korean exports, accounting for over one-quarter of that trade, and Korea's second largest supplier of imports, accounting for over one-fifth of the total.<sup>14</sup> To assist in this two-way flow of trade, in ways discussed below, FDI engaged principally in retail and especially wholesale trade accounted for nearly one-half of all Korean stocks in the United States. So large are Korean investments in this US sector that they represented approximately two-thirds of all Korean FDI engaged in wholesale and retail trade around the world. Beyond wholesaling, the United States was also the single largest host to Korean FDI engaged in manufacturing, which accounts for more than one-fifth of all Korean stocks in the United States. There, the largest share of Korean manufacturing FDI produces basic metals which, as we shall see below, are

destined for sale principally in the domestic US market--the sales destination for most multinationals operating in the United States.

Indonesia has long been the second largest destination for Korean FDI, accounting for less than one-half the stocks invested in the United States during 1993--but well above any other Asian destination. In marked contrast to the United States, Indonesia hosts negligible Korean FDI engaged in either wholesale or retail trade. Of course, for Korea, Indonesia is neither a leading export market (ranked eight in 1992) nor a leading import source (ranked seventh).<sup>15</sup> What is imported from Indonesia, however, consists principally of petroleum and other natural resources. In these sectors, Indonesia is the largest single destination worldwide for Korean FDI, accounting for nearly two-fifths of all Korean FDI stocks. As a result, Korean FDI in petroleum and other natural resources, presumably for export back home, accounted for well over one-half of all Korean FDI in Indonesia during 1993. What remained of Korean FDI in Indonesia was engaged principally in manufacturing a wide range of products, of which textiles and leather products contributed the largest share. Since textiles and leather products figure prominently among Korean exports to the United States and elsewhere,<sup>16</sup> it seems safe to assume that Korean multinationals in these sectors are also exporting their Indonesian products to these critical markets--a common strategy, as we shall see below, for all multinationals operating in Asia.

China only recently emerged as the third largest destination for Korean FDI, accounting for nearly 9 percent of all stocks in 1993, up from less than one percent as recently as 1990.<sup>17</sup> While Korean multinationals have focused more on wholesale trade in the United States and on natural resources in Indonesia, they have concentrated nearly all of their FDI in China in the manufacturing sector. There, Korean manufacturers produced a broad range of products, of which textiles and leather products again contributed the largest share. While the domestic Chinese market undoubtedly consumes a sizable proportion of this manufactured output, much of that output--especially

textiles and leather products--is again presumably exported either back home for additional processing or directly to the United States and other third-country markets. Thus, China is emerging as the largest single Asian repository of Korean manufacturing outside of Korea itself.

For newly-emergent Asian multinationals, especially those based in Hong Kong and Taiwan, China has emerged as the largest single destination for their FDI. But the actual size of their FDI in China is difficult to calculate. For example, the World Bank estimated that roughly \$4 out of every \$11 directly invested in China during 1992 was actually domestic Chinese investment temporarily recycled through Hong Kong in order to receive foreign-investment incentives upon reentry into China (so-called "round-tripping"). Applying this estimate to 1993 means that \$27.5 billion of recorded FDI inflows should actually be reduced to \$17.5 billion of actual FDI inflows (see Table 1).

Of this sum, between three-quarters<sup>18</sup> and four-fifths<sup>19</sup> originates in either Hong Kong or Taiwan. Among these two sources, the precise division remains unclear for at least two reasons. First, until recently, capital controls in Taiwan limited (if not proscribed) direct flows of capital from Taiwan to China; to circumvent such controls, Taiwanese investors reportedly channeled their FDI through Hong Kong as an intermediary stop on their way to China. Second, the Taiwanese are not the only foreign investors who have routed their FDI first through their subsidiaries in Hong Kong before entering China, even in the absence of capital controls back home. Even though both routings inflate Hong Kong's contribution to FDI in China, that contribution probably still exceeds \$13 billion. This sum certainly represented roughly one-third of all FDI flows to Asia during 1993, and probably represented well over one-half of all FDI flows across Asia recorded by ethnic Chinese multinationals.

Of course, China is not the only host of intra-regional FDI inflows from either Hong Kong or Taiwan, as the case of Thailand illustrates.<sup>20</sup> Nor are Hong Kong and Taiwan the only home bases for ethnic Chinese multinationals, many of which also arise

from the Chinese communities located either in Singapore or scattered across the rest of ASEAN (mainly Indonesia, Malaysia, the Philippines, Thailand). Indeed, a Sino-Thai conglomerate, CP, is reportedly the largest single foreign investor in China. Meanwhile back in Thailand, largely ethnic Chinese investors based in Hong Kong, Singapore, and Taiwan contributed nearly two-fifths of all FDI inflows between 1990 and 1993, finally surpassing Japan (the largest source of FDI inflows during the second half of the 1980s), and double the relative contribution of US FDI inflows. In short, ethnic Chinese multinationals have emerged as a major source of intraregional FDI flows, especially in east and southeast Asia.

Not only is the Asian FDI of ethnic Chinese corporations more widely dispersed geographically, but also sectorally. In Asian manufacturing, if there is a bias, it is toward agribusiness, electronics, and textiles. Among services, FDI ranges broadly from construction and real estate, to financial services, to wholesale and retail trade. Perhaps only in extractive industries is the range of Asian investments smaller in mining and petroleum than that recorded by American and Japanese multinationals. In short, the Asian investments of ethnic Chinese multinationals are becoming ever-more diffused across countries and industries--moving in a direction opposite that of the Americans, but consistent with that of Asia's other intra-regional investors, the Japanese and Koreans.

## **OPERATIONAL CHARACTERISTICS OF MULTINATIONALS**

The present study extends earlier comparisons of American and Japanese multinationals to identify and explain emerging similarities and persistent differences in the strategies and structures these MNCs have adopted across Asia and elsewhere in the world. Of particular concern, in light of prior research, is the multinational management of an interrelated series of strategic trade-offs concerning both the strategy

and structure of foreign operations.<sup>21</sup> These trade-offs are stylized below as six sets of binary choices affecting a multinational's shareholdings, sales, value-added, markets, sourcing, and trade. Such choices are common to all multinational corporations, and thus permit a comparative analysis of American and Japanese multinationals in Asia and elsewhere across the Triad.

### **Shareholdings: Majority Subsidiaries vs. Minority Affiliates**

Choices regarding equity ownership and managerial control are among the first to be confronted by all multinationals investing abroad. The logic for majority ownership and undisputed control is often compelling: MNCs create and sustain a competitive advantage through the skillful management of tangible and intangible assets in technology, marketing, organization; such assets are specific to each individual firm, and are often best exploited when that firm owns a majority (including all) of the equity shareholdings in its foreign subsidiaries. Compared to minority shareholdings, a majority position can grant the multinational parent a higher degree of managerial control over the foreign use of that firm-specific assets. Such managerial control, in turn, often helps to reduce the high costs that can plague more "arm's-length" transactions between foreign suppliers of firm-specific assets and unaffiliated buyers overseas. Instead of using such arm's-length transactions, these foreign suppliers transfer their tangible and intangible assets internally--directly to their majority-owned subsidiaries abroad. Later, reverse transfers also take place, as foreign subsidiaries begin to ship goods and services back to their multinational parent, as well as to other related affiliates overseas. In the end, this circular flow enhances the total pool of technological, marketing, and organizational assets available to both the multinational parent and its majority subsidiaries.

At least since the Second World War, American multinationals have consistently invested in majority-owned subsidiaries, rather than in minority-owned affiliates.

Indeed, as early as 1957, U.S. MNCs reported to the U.S. Commerce Department (in its first postwar census of the foreign operations of U.S. companies) that they owned upwards of three-quarters of the equity invested in their subsidiaries abroad.<sup>22</sup> For the Americans, relative shareholdings continued to grow slowly over the next decade,<sup>23</sup> so that by 1992 majority U.S. subsidiaries accounted for over four-fifths of the assets owned by American multinationals abroad (see Table 3). As a result of these investments, U.S. MNCs reported that their majority-owned subsidiaries contributed an ever-larger share of their total foreign sales: reaching three-quarters by 1966 (in the Commerce Department's first "benchmark" survey of U.S. FDI<sup>24</sup>), and climbing to over four-fifths by 1992 (in the Department's most recent annual survey, summarized in Table 3). What little remained was dispersed across equal-partnership joint ventures and minority U.S.-owned affiliates. Thus today, for American multinationals, majority ownership of foreign subsidiaries remains a prominent characteristic of their foreign-investment strategies.

-- INSERT TABLE 3 HERE --

Similarly, majority ownership has become central to the investment strategies of Japanese multinationals. Indeed, for 1992 (again, the most recent year for which comprehensive data are available), Japanese multinationals reported to Japan's Ministry of International Trade and Industry (MITI) that majority-owned subsidiaries accounted for over two-thirds of the capital invested in their subsidiaries abroad (see Table 3). As a result of that investment, Japanese multinationals reported that their majority subsidiaries contributed four-fifths of their foreign sales--a share roughly comparable to sales reported by the majority subsidiaries of American multinationals.<sup>25</sup>

TABLE 3

**OVERSEAS SALES AND ASSETS BY LEVEL OF FOREIGN SHAREHOLDINGS, ACROSS  
REGIONS, 1992-93**
**AMERICAN MULTINATIONALS ABROAD, 1992**

	<u>Worldwide</u>	<u>North America</u>	<u>Western Europe</u>	<u>In Japan</u>	<u>Other Asia</u>	<u>Of which, Korea</u>
<b>Sales</b>						
\$ billion	\$1,578.7	\$232.1	\$858.8	\$161.7	\$120.0	\$11.8
% by:						
Majority <sup>a</sup>	82.3%	88.4%	89.1%	44.6%	83.8%	33.9%
Minority <sup>b</sup>	17.7%	11.6%	10.9%	55.5%	16.2%	66.1%
<b>Assets:</b>						
\$ billion	\$1,746.8	\$240.0	\$947.7	\$163.9	\$108.8	\$11.5
% by:						
Majority <sup>a</sup>	82.3%	84.9%	89.9%	54.4%	77.1%	33.9%
Minority <sup>b</sup>	17.7%	15.1%	10.1%	45.6%	22.9%	66.1%

**FOREIGN MULTINATIONALS IN THE UNITED STATES, 1992**

	<u>All Foreign MNCs</u>	<u>European MNCs</u>	<u>Japanese MNCs</u>	<u>Other Asian MNCs</u>	<u>Of which, Korean MNC</u>
<b>Sales</b>					
\$ billion	\$1222.7	\$534.5	\$334.8	\$22.4	\$9.5
of which:					
Majority <sup>a</sup>	85.3%	88.9%	90.9%	88.4%	89.5%
Minority <sup>b</sup>	14.7%	11.1%	9.1%	11.6%	10.5%
<b>Assets:</b>					
\$ billion	\$1,809.9	\$752.7	\$458.5	\$34.8	\$8.0
% by:					
Majority <sup>a</sup>	79.8%	80.6%	87.1%	99.7%	88.7%
Minority <sup>b</sup>	20.2%	19.4%	12.9%	0.3%	11.3%

**JAPANESE MULTINATIONALS ABROAD, 1992**

	<u>Worldwide</u>	<u>North America</u>	<u>Western Europe</u>	<u>Asia</u>
<b>Sales</b>				
\$ billion	\$633.2	\$268.8	\$178.7	\$124.7
% by:				
Majority <sup>a</sup>	80.1%	86.9%	77.4%	69.2%
Minority <sup>b</sup>	19.9%	13.1%	22.6%	30.8%
<b>Capital:</b>				
\$ billion	\$88.1	\$43.3	\$16.6	\$15.5
% by:				
Majority <sup>a</sup>	69.9%	83.6%	74.7%	53.6%
Minority <sup>b</sup>	30.1%	16.4%	25.3%	46.4%

**KOREAN MULTINATIONALS ABROAD, 1993**

	<u>Worldwide</u>	<u>North America</u>	<u>Western Europe</u>	<u>Asia</u>
<b>INVESTMENT</b>				
\$ billion	\$5.6	\$2.2	\$0.6	\$2.2
% by:				
Majority <sup>a</sup>	79.9%	93.4%	79.6%	71.6%
Minority <sup>b</sup>	20.1%	6.6%	20.4%	28.4%

**TABLE 3** (continued)

**Notes:** <sup>a</sup>Majority foreign-owned subsidiaries.

<sup>b</sup>Minority foreign-owned subsidiaries and equal partnership (50:50) joint ventures.

**Sources:** US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1992 Estimates (Washington: USGPO, June, 1994), Tables II.A.1 and III.A.1, n.p.; U.S. Direct Investment Abroad: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Tables A-2 and N-4, n.p.; Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The Fifth Comprehensive Survey of Foreign Investment Statistics [Dai go-kai wagakuni kigyo no kaigai jigyo katsudo]. (Tokyo: MITI, 1994), Tables 2-9 and 4-2, pp. 134, 481; Bank of Korea, Foreign Exchange Department, Overseas Direct Investment Statistics Yearbook: 1994 (Seoul: BOK, 1994), Table 11.4, pp. 70-71.

Korean and other Asian multinationals report a similar preference for majority ownership. For example, in the United States (the one country where comparable data are available, reported in Table 3), they all report that majority-owned subsidiaries contributed nearly nine-tenths of their sales and accounted for nearly all of their assets. Moreover, this preference for majority ownership seems to have strengthened over time. Majority Korean-owned subsidiaries, for example, accounted for just over one-half (56 percent) of all Korean investments abroad as recently as 1987.<sup>26</sup> But by 1993 (the most recent year for which data are available) they reported to the Bank of Korea that majority Korean-owned subsidiaries accounted for nearly four-fifths of their net investments abroad--a share comparable to that reported by American and Japanese multinationals. As a result, Korean and other Asian (principally ethnic Chinese) multinationals have become indistinguishable from their American and Japanese counterparts in the shared pursuit of majority ownership in foreign subsidiaries.

For all of these multinationals, however, the incidence of majority ownership varies across industries, and especially across the value-added chain. On the extremes of that chain, subsidiaries engaged principally in overseas distribution, generally evidence a larger proportion of foreign shareholdings than do those subsidiaries engaged principally in natural-resource extraction abroad. As a result, American and Japanese multinationals report that their majority mining or petroleum subsidiaries account for below-average investments and sales, while their majority-owned manufacturers and especially wholesalers are above-average.<sup>27</sup> Such variation within and across industries reflects, in part, differences in financial (and other operational) risks, especially since average investments are typically lower in downstream wholesaling than, say, in upstream mining or refining, where greater risks may be shared with joint-venture partners. Moreover, variations in ownership patterns also reflect differences in a multinational's need for managerial control, since (as we shall see

below) downstream wholesaling is often tightly linked to intra-firm trade between multinational parents and their foreign subsidiaries.

Moreover, within any one of these sectors (say, manufacturing), additional variation can be found, reflecting important differences in firm-specific assets and industrial structures. In textiles, for example, Japanese manufacturers often teamed up with Japanese trading companies (*sogo shosha*), which could claim extensive trading experience across Asia: By 1974, at least three such *sogo shosha*--C. Itoh, Marubeni, and Mitsui--had invested aggressively in Asian textiles, typically through multi-party joint ventures with Japanese manufacturers.<sup>28</sup> Moreover, while establishing these subsidiaries, Japanese trading companies showed particular biases reflecting longer-term structural relationships between traders and manufacturers: C. Itoh and Marubeni spread their investments among Japan's three largest textile manufacturers (Toray, Teijin and Toyobo); Mitsui concentrated its investments in Toray alone. By concentrating their investments in this way, and by teaming manufacturers with traders in a single joint venture, Japanese multinationals could insure majority Japanese shareholdings.

Yet, while *sogo shosha* often proved crucial to Japanese investments in Asian textiles, they remained notably absent from electronics and most other industries--where joint ventures with local partners also proved of less value.<sup>29</sup> For example, during the 1970s, the median Japanese equity holding in Asian textiles was 51 percent; meanwhile, in electronics, Japanese shareholdings reached figures as high as 66 percent, the industry-wide average at that time. As we shall see below, electronics and other differentiated products, especially those requiring after-sales service, often require producers to integrate vertically from production to distribution, prompting little demand for the commodity-trading expertise of Japanese trading companies or the host-market expertise of local partners.

In addition, variations in shareholding patterns also reflect wide differences in the government policies prevailing across host countries. For example, the incidence of capital controls is generally lower in industrialized North America than in the European Union, and lower in these two regions than in Asia. As a result, American and Japanese multinationals report that the incidence of majority foreign ownership is generally higher in North America than in Western Europe, and higher in the EU than in Asia (see Table 3). Moreover, within these regions, the incidence of majority shareholdings varies widely across countries.<sup>30</sup> In Asia, for example, Hong Kong and Singapore have the highest incidence of majority foreign ownership. Given a multinational's strong preference for majority ownership, plus the several locational advantages of Hong Kong and Singapore, both economies (as we saw above) ranked among the top three investment destinations for American and Japanese multinationals in Asia (see Table 1).

By contrast, India lost its early post-war ranking among the top Asian destinations for American multinationals in part because domestic capital controls severely limited both the inflow of FDI and the subsequent level of foreign ownership.<sup>31</sup> As a result, as recently as 1992, majority U.S.-owned subsidiaries accounted for less than one-quarter of either the sales or the assets of all U.S.-affiliated companies operating in India,<sup>32</sup> up only slightly from one-fifth of total sales and assets nearly two decades earlier, in 1977.<sup>33</sup> Similarly, in Korea, limited investments in majority U.S.-owned subsidiaries generated barely one-third of the sales recorded by all American multinationals operating there, up from one-fifth back in 1977. As a result, both countries have come to attract very little new FDI from either American or Japanese multinationals; to reverse this trend, both countries have begun to relax their capital controls as part of a larger liberalization of their national economies.

Yet, long after capital liberalization, Japan illustrates the extreme impact that a long legacy of capital controls continues to have on foreign ownership patterns.<sup>34</sup> Specifically, in Japan, limited investments in majority U.S.-owned subsidiaries still

generated less than one-half of the sales recorded by all American multinationals as recently as 1992 (see Table 3), more than a decade after formal liberalization. The remainder, accounting for most multinational sales in Japan, still came from minority U.S. affiliates even though the relative position of these minority affiliates had actually declined over the previous decade, thanks in large part to the liberalization of capital controls. Indeed, with such a great preponderance of minority affiliates, Japan actually has more in common with newly-industrializing Korea and developing India than with most other Asian countries, which on this measure have more in common with the several countries of North America and Western Europe.

### **Sales: Foreign Investment vs. International Trade**

After securing majority ownership and managerial control, multinationals often employ their foreign subsidiaries to sell in overseas markets far more than they and other exporters back home ship to these same markets. As a practical matter, pressures to increase foreign sales through direct investment abroad, and not just through international trade alone, increase when any of several conditions arise: when foreign governments severely constrain or credibly threaten to limit imports; when global competitors derive significant cost and other country-specific advantages from their overseas location; when indigenous buyers in large markets demand closer relations with their foreign suppliers; and when foreign exporters seek to hedge against exchange-rate risks by matching both revenues and costs in the same currency. Otherwise, multinationals will continue to supply offshore markets through international trade. Thus, the strategic choice is often viewed simply (and, as we shall see below, somewhat incorrectly) as one between foreign investment and international trade.

For the Americans, the predominance of foreign sales derived from FDI rather than from international trade is not new.<sup>35</sup> As early as 1957, the foreign (largely

majority U.S.-owned) subsidiaries of American multinationals reported total overseas sales at twice the value of total U.S. exports.<sup>36</sup> A decade later, by 1966, the combined foreign sales of these majority U.S. subsidiaries had risen to represent three times the value of all U.S. exports.<sup>37</sup> Subsequently, that 3:1 ratio of foreign sales to U.S. exports has remained largely unaltered. In fact, during 1992, American multinationals continued to sell nearly three times as much overseas through their majority subsidiaries than the United States exported to the world (see Table 4)--further testimony to the fact that U.S. FDI continues to carry international competition well beyond cross-border trade.

-- INSERT TABLE 4 HERE --

Similarly, Japanese corporations have also come to generate more of their overseas sales through foreign investment rather than through international trade. But for the Japanese, this evolution is of very recent origin, reflecting their prolonged status as traders rather than investors. In fact, as late as 1977, Japanese subsidiaries reported total foreign sales to be roughly equivalent to Japanese exports worldwide.<sup>38</sup> But by 1992, following a decade of rapid growth in Japanese FDI abroad, Japanese subsidiaries (most of which were majority Japanese-owned) reported foreign sales nearly two times larger than all Japanese exports worldwide (see Table 4). Thus, beginning in the 1980s and continuing into the 1990s, Japanese multinationals have begun to follow the lead of their American counterparts by generating more overseas sales through foreign investment than through international trade.

For both the Americans and the Japanese, the relative mix of overseas sales generated either by foreign investment or international trade again varies widely across regions and industries. On one extreme is Western Europe, where both the majority subsidiaries of American and Japanese multinationals record above-average sales. In

TABLE 4

**THE RATIO OF FOREIGN SALES BY MULTINATIONAL SUBSIDIARIES TO U.S. AND JAPANESE TRADE, 1992**

THE RATIO OF U.S. SUBSIDIARIES' SALES ABROAD TO U.S. EXPORTS, 1992

Location of Subsidiaries/ Destination of Exports:	Foreign Sales by Majority US Subsidiaries (A)	US Exports (B)	Ratio of Sales to Exports (A/B)
All Countries (\$ bil.)	\$1,298.5	\$448.2	2.9
of which:			
North America	\$205.2	\$131.2	1.6
European Community	\$678.7	\$103.0	6.6
Japan	\$72.1	\$47.8	1.5
Other Asia	\$100.6	\$79.1	1.3
	\$4.0	\$14.6	0.3

Of which, Korea

THE RATIO OF FOREIGN AFFILIATES' SALES IN THE UNITED STATES TO U.S. IMPORTS, 1992

National Origin of Subsidiaries/ Source of Imports	US Sales by Majority Foreign Subsidiaries (A)	US Imports (B)	Ratio of Sales to Imports (A/B)
All Countries (\$ bil.)	\$1,043.1	\$532.7	2.0
of which:			
European Community	\$475.2	\$94.0	5.1
Japan	\$304.4	\$97.4	3.1
Other Asia	\$19.7	\$135.7	0.1
Of which: Korea	\$8.5	\$16.1	0.5

THE RATIO OF JAPANESE AFFILIATES' SALES ABROAD TO JAPANESE EXPORTS, 1992

Location of Sales/ Destination of Exports:	Foreign Sales by Japanese Affiliates (A)	Japanese Exports (B)	Ratio of Sales to Exports (A/B)
All Countries (\$ bil.)	\$633.2	\$340.0	1.9
of which:			
North America	\$268.8	\$107.6	2.5
European Community	\$178.7	\$62.9	3.0
Asia	\$124.7	\$117.6	1.1

Sources: US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1992 Estimates (Washington: USGPO, June 1994), Table III.E.3, n.p.; Foreign Direct Investment in the United States: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Table E-4, n.p.; International Trade Administration, Office of Trade and Investment Analysis, US Foreign Trade Highlights: 1993 (Washington, DC: USGPO, July 1994), Tables 14 and 15, pp. 34-41; Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The Fifth Comprehensive Survey of Foreign Investment Statistics [Dai go-kai wagakuni kigyo no kaigai jigyo katsudo]. (Tokyo: MITI, 1994), Table 2-25, pp. 188-199; International Monetary Fund, Direction of Trade Statistics Yearbook: 1993 (Washington, DC: IMF, 1993), pp. 240-242.

fact, during 1992, the majority U.S.-owned subsidiaries sold in Europe over six times more than did all U.S.-based exporters (see Table 4). Leading the way here during 1992 were U.S. automakers and component suppliers, who sold over 20 times more through majority subsidiaries operating in the EC than they did through U.S. exports to the EC.<sup>39</sup> By comparison, Japanese automakers lagged their U.S. counterparts, as did most of Japanese industry. Consequently, Japanese subsidiaries in Europe sold three times more than did all Japan-based exporters--well above their worldwide average, but one-half the comparable ratio reported by the Americans (see Table 4).

Moreover, for the Japanese, this 3:1 ratio was somewhat new, in marked contrast to the Americans, who can trace their quite stable 6:1 ratio back at least to the mid-1960s.<sup>40</sup> By then, several factors combined to attract the foreign investments of American and, later, Japanese multinationals to Europe: the growth in European demand for sophisticated products already available in the United States and Japan, the erection of common EC barriers to U.S. and Japanese exports of these products, the reduction of comparable barriers to internal EC trade of these products, the emergence of scale economies in the production and distribution of these products, and the exertion of formidable pressures by both strong European buyers and powerful European competitors.

These same pressures have also pulled European and, more recently, Japanese multinationals to the United States. Among the first to respond, European subsidiaries in the United States during 1992 sold over five times more than did European exporters (see Table 4)--thus approaching the ratio of foreign sales to exports recorded by the Americans in Europe for over 30 years. But for the Europeans, that 5:1 ratio has lagged the Americans by at least a couple of decades. By 1974, for example, European subsidiaries sold three times more in the United States than did European-based exporters.<sup>41</sup> Like the Europeans back then, so too the Japanese by 1992, reported that their majority subsidiaries in the United States sold over three times more than did

Japanese exporters (see Table 4). For the Japanese, this ratio of U.S. sales to exports was nearly double their worldwide average, and was of very recent origins: just five years earlier, in 1987, the ratio of foreign sales to international trade was barely over 2:1.<sup>42</sup> By increasing the ratio of foreign sales to national exports, Japanese corporations are following a similar evolutionary path to that charted earlier by European multinationals in America, and by American multinationals in Europe.

Ranked well behind both the Japanese and (especially) the Europeans are Korean and other Asian multinationals. For example, in 1992, majority Korean subsidiaries operating in the United States reported U.S. sales with one-half the value recorded then by all U.S. imports from Korea (see Table 4)--up from less than 40 percent of the value just five years earlier, in 1987.<sup>43</sup> During those five years, the nominal value of U.S. imports from Korea remained roughly constant, while the corresponding value of Korean FDI in the United States nearly tripled.<sup>44</sup> As a result, the recent growth of US sales generated by majority Korean subsidiaries in the United States outpaced comparable sales generated by Korean exports. In comparison with the Koreans, however, other Asian multinationals still remain far more dependent on international trade to generate their US sales. By this measure, then, Korean multinationals are much further advanced than other Asian multinationals in their evolution along the same path charted earlier by European and Japanese multinationals in the United States.

Extending that same evolutionary path back to Asia, however, has been difficult. To understand why, consider the fate of foreign subsidiaries in Japan. There, by 1992, majority U.S. subsidiaries fared only slightly better than did U.S.-based exporters (see Table 4); similarly, European multinationals also reported low levels of foreign sales to match an equally low level of exports.<sup>45</sup> Nevertheless, these figures represented a modest improvement over the previous decade: In 1982, Japanese sales by majority U.S. subsidiaries were nearly identical to those of U.S.-based exporters.<sup>46</sup> Specifically, in Japan, several factors help to account for such limited market access.<sup>47</sup> Early on,

import protection combined with capital controls both to limit overall FDI inflows and to concentrate those inflows in minority foreign-owned affiliates. This legacy, however, has begun to change with trade and capital liberalization--but only slowly, since liberalization came well after fresh outflows of U.S. FDI reached their postwar high (during the late 1960s and early 1970s). Subsequently, fresh outflows of U.S. FDI actually fell off, to be replaced by reinvested earnings in existing subsidiaries.<sup>48</sup> But without investment earnings to reinvest, American multinationals soon realized that Japanese industrial organization had come to replace Japanese government policies as the principal barriers to market access in Japan. As a result, American and European multinationals have moved at a slower pace in Japan as they progress along an evolutionary path charted earlier by them--and later followed by Japanese multinationals--in other industrialized countries.

Meanwhile, elsewhere in Asia, progress on that same evolutionary path has also proved difficult, not only for American multinationals, but also for the Japanese. Specifically, both reported in 1992 that foreign sales generated through foreign investment were slightly larger those generated through international trade (see Table 4). Moreover, the ratio of subsidiaries' sales to international trade has actually declined over the past decade, at least for the Americans: In 1982, foreign sales by majority U.S. subsidiaries in Asia were actually twice the value of all U.S. exports to that region,<sup>49</sup> not near the parity reported in 1992 (see Table 4). It seems that trade and capital liberalization over the past decade in Asia had a differential impact on the Americans, favoring U.S. exports more immediately than U.S. FDI: Between 1982 and 1992, the value of U.S. exports to Asia actually tripled, while the value of foreign sales by majority U.S. subsidiaries in Asia only doubled. By contrast, for the Japanese, subsidiaries' sales and exports both grew fourfold in Asia between 1980 and 1992,<sup>50</sup> leaving the ratio of subsidiaries' sales to exports roughly comparable. As a result of these different changes, Asia has little in common with the more advanced market--not

just in North America and Western Europe, but also Japan--where the historical evolution of both American and Japanese multinationals favors foreign investment over international trade as the preferred means for generating foreign sales.

However, the relative mix of overseas sales generated either by foreign investment or international trade varies widely across the region. In Korea, for example, 1992 sales by majority U.S. subsidiaries still fail to equal U.S. exports there given the limited value of U.S. FDI in that country. By contrast, in Singapore, the second largest Asian host to U.S. FDI, the sales of majority U.S. subsidiaries are three times larger than U.S. exports there<sup>51</sup>--roughly the same ratio recorded by the Japanese in both North America and Western Europe (see Table 4). Between the extremes represented by Singapore and Korea, however, the rest of Asia looks more like Japan, at least when measured by the near-parity in foreign sales generated by both U.S. investors and U.S. exporters operating across the region.

Compared to either the Americans or the Japanese in Asia, Korean multinationals seem much less reliant on foreign investment, and far more reliant on international trade, to generate their Asian sales. In this region, Japan, Hong Kong, and Singapore are Korea's three largest export markets. Of these, neither Hong Kong nor Singapore ranked among the top ten hosts for Korean FDI in 1993. Only Japan ranked among the top five hosts, but over two-thirds of all Korean FDI there was concentrated in real estate,<sup>52</sup> with little obvious impact on trade. Most of the remaining Korean FDI in Japan was concentrated in the wholesale sector, where it presumably did provide limited sales support for Korean exports. Elsewhere in Asia, however, Korean FDI was concentrated not in downstream exports markets, but rather in geographic locations--notably Indonesia and China--where FDI in offshore manufacturing and natural-resource extraction serve as potential sources of upstream supply for markets back home and in third countries.

### **Value-Added: Offshore Production vs. Overseas Distribution**

To generate their foreign sales, multinational corporations often invest in majority-owned subsidiaries that produce offshore goods and services that are then supplied to markets both abroad and back home. In addition to the more general pressures promoting FDI outlined above, that investment is more likely to establish offshore production when national governments not only limit imports but also promote exports; when factor costs, relative productivity, and other location-specific advantages figure prominently in global competition; and when erstwhile exporters can significantly reduce their exchange rate risks by matching more of their costs in the same currency as their revenues. Otherwise, multinationals will continue to supply offshore markets through international trade, often supplemented by direct investments in overseas distribution. Such distribution is especially important in industries where multinationals derive distinct competitive advantages by establishing dedicated sales channels and by offering more after-sales service.

Quick to respond to the pressures for offshore production have been the Americans: At least as early as 1957, and continuing for more than three decades,<sup>53</sup> the value of offshore production by American multinationals was nearly twice the value of U.S. manufactured exports (see Table 4). The Americans concentrated most of their foreign manufacturing in advanced markets, especially in the European Community, where during 1992 majority U.S.-owned manufacturing subsidiaries generated sales over four times larger than U.S.-based manufacturers exported to the EC (see Table 4). To illustrate an extreme case, consider how American automakers and parts suppliers generate their European sales: During 1990, for example, U.S. auto exports (including parts and components) to the EC totaled roughly \$3 billion; compare this sum to the sales generated both in local host markets (\$37 billion) and in nearby regional markets (\$34 billion) by the EC plants of U.S. automakers.<sup>54</sup> For American corporations, then,

direct investment in offshore production has become their principal strategy for gaining and maintaining market access in the EC.

-- INSERT TABLES 5 HERE --

Like the Americans in the European Community, so too the Europeans in the United States have come to employ direct investment in offshore production as their principal strategy for gaining and maintaining market access. But their movement is of more recent origin. As late as 1974, the value of U.S. production by European multinationals roughly equaled U.S. imports of European manufactured goods.<sup>55</sup> (Even when we add to this figure the estimated value of additional assembly operations by European subsidiaries engaged principally in U.S. wholesaling, the total value of local production probably does exceed all U.S. imports from Europe.) Still, such offshore manufacturing remained well below comparable production by American multinationals in Europe. However, over the next two decades, the Europeans moved to cut this difference in half, so that by 1992 their manufacturing subsidiaries in the United States actually reported U.S. sales nearly two-and-half times larger than U.S. imports of European manufactured goods (see Table 5). As a result, both American and European multinationals have generally managed to produce and sell many more manufactured goods in each other's home market than they and other national exporters shipped across the Atlantic.

In contrast to both the Americans and the Europeans, Japanese multinationals have continued to pursue a very different offshore-manufacturing strategy, one that still lags Japanese exports of manufactured goods. As recently as 1992, for example, foreign sales resulting from offshore production by Japanese subsidiaries in North America and the EC were less than three-quarters the total value of Japanese manufactured exports to these markets (see Table 5). Even when we add to these local

**TABLE 5**

**OFFSHORE PRODUCTION, MANUFACTURED EXPORTS, AND OVERSEAS DISTRIBUTION BY AMERICAN, EUROPEAN, AND ASIAN MULTINATIONALS, 1992**

**AMERICAN MULTINATIONALS ABROAD, 1992**

Location of Subsidiaries/ Destination of Exports:	Sales by Majority US Subsidiaries Engaged Principally in Manufacturing	US Exports of Manufactured Goods	Sales by Majority US Subsidiaries Engaged Principally in Wholesaling
All Countries (\$ bil.) of which, in:	\$629.5	\$368.5	\$242.2
North America	\$120.6	\$115.4	\$22.8
European Community	\$369.8	\$87.1	\$124.1
Japan	\$28.4	\$30.3	\$19.5
Other Asia	\$36.6	\$59.9	\$21.7

**FOREIGN MULTINATIONALS IN THE UNITED STATES, 1992**

National Origin of Subsidiaries/ Source of Imports	Sales by Foreign Affiliates Engaged Principally in US Manufacturing	US Imports of Manufactured Goods	Sales by Foreign Affiliates Engaged Principally in US Wholesaling
All MNCs (\$ billion) of which, from:	\$427.0	\$434.3	\$374.0
European Community	\$217.6	\$84.1	\$112.0
Japan	\$68.3	\$95.8	\$214.2
Other Asia	\$6.4	\$112.4	12.4
Of which: Korea	\$1.2	\$16.3	\$8.1

**JAPANESE MULTINATIONALS ABROAD, 1992**

Location of Sales/ Destination of Exports:	Sales by Japanese Affiliates Principally Engaged in Foreign Manufacturing	Japanese Exports of Manufactured Goods	Sales by Japanese Affiliates Principally Engaged in Foreign Wholesaling
All Countries (\$ bil.) of which, in:	\$201.3	\$340.0	\$391.0
North America	\$80.7	\$107.6	\$173.4
European Community	\$42.1	\$62.9	\$125.7
Asia	\$63.7	\$117.6	\$54.8

Sources: US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1992 Estimates (Washington: USGPO, June 1994), Table III.E.3, n.p.; Foreign Direct Investment in the United States: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Table E-4, n.p.; International Trade Administration, Office of Trade and Investment Analysis, US Foreign Trade Highlights: 1993 (Washington, DC: USGPO, July 1994), Tables 14 and 15, pp. 34-41; Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The Fifth Comprehensive Survey of Foreign Investment Statistics [Dai go-kai wagakuni kigyo no kaigai jigyo katsudo]. (Tokyo: MITI, 1994), Table 2-25, pp. 188-199; International Monetary Fund, Direction of Trade Statistics Yearbook: 1993 (Washington, DC: IMF, 1993), pp. 240-242.

sales the assembly operations of Japanese subsidiaries engaged principally in overseas distribution, the total value of Japanese production in America and Europe still barely equals U.S. or European imports of manufactured goods from Japan. For the Japanese, however, this low ratio of foreign production to international trade actually represented a significant increase in offshore manufacturing. Indeed, less than two decades earlier (in 1977), Japanese manufacturers and (to a much lesser extent) Japanese trading companies had reported exports from home four times larger than the worldwide production recorded by Japanese subsidiaries abroad.<sup>56</sup> Yet, despite such growth, these Japanese subsidiaries had little in common either with American multinationals in Europe or with EC multinationals in the United States.

Instead, the Japanese in America and Europe share more in common with the Americans and Europeans in Japan. There, as recently as 1992, majority U.S.-owned manufacturing subsidiaries recorded foreign sales roughly equal in value to U.S. manufactured exports there (see Table 5). The Americans, of course, are not alone in their failure to implement the same offshore production strategy that served them so well in other industrialized countries. To the contrary, European multinationals also evidence the same low level of Japanese production to match their limited exports to Japan.<sup>57</sup> Nevertheless, for foreign multinationals in Japan, these 1992 ratios represented a significant improvement from just a decade earlier. In 1982, for example, majority U.S.-owned manufacturing subsidiaries recorded foreign sales roughly one-half the value of U.S. manufactured exports there.<sup>58</sup> Subsequently, even as U.S. manufactured exports to Japan grew, the Japanese sales of U.S. manufacturers operating majority subsidiaries in Japan grew even faster. This is the most obvious impact in Japan of increased U.S. FDI in majority subsidiaries, an increase made easier by the liberalization of Japanese capital controls. With such growth in local production, American (and European) multinationals have only recently begun to follow in Japan an evolutionary path charted much earlier by them in North America and Western Europe.

Progress along that evolutionary path has advanced less quickly elsewhere in Asia, the one region where both American and Japanese multinationals do have much in common. Specifically, both rely more on international trade than offshore production to generate sales in that region. In fact, majority U.S. subsidiaries manufacturing in Asia reported 1992 sales roughly three-fifths the value of all U.S. manufactured exports to that region (see Table 5), just slightly more than the comparable ratio for the Japanese. Moreover, these ratios had improved only marginally over the last decade, at least for the Americans: Between 1982 and 1992, both U.S. manufactured exports to Asia and sales by majority U.S. manufacturing subsidiaries had both more than tripled.<sup>59</sup> However, for the Japanese, the rapid rise of Japanese FDI in Asian manufacturing had significantly altered the ratio of offshore production to manufactured trade: Between 1980 and 1992, even as Japanese exports to Asia grew fourfold, the offshore production of Japanese subsidiaries in the region grew six fold.<sup>60</sup> Yet, even though American and Japanese multinationals had both increased their FDI in Asian manufacturing during the 1980s, the resulting production from that investment had still not overtaken manufactured exports as the principal source of supply.

Moreover, wide variation in the ratio of local production to manufactured trade can be also discerned across countries. On one extreme is Singapore where, as recently as 1982, U.S. exports were much larger than total sales by U.S. subsidiaries manufacturing there. But a decade of ever-increasing FDI by American manufacturers in Singapore dramatically reversed that ratio, so that by 1992 the majority subsidiaries of these U.S. manufacturers reported sales from local production with a total value greater than all U.S. manufactured exports to Singapore.<sup>61</sup> By contrast, on the other extreme is India. There, the value of local production by majority U.S. subsidiaries remained well below the value of otherwise small U.S. exports to India-- and the value of that local production had actually declined over the prior decade despite a modest increase in U.S. trade. In short, while Singapore has emerged as a major offshore

production site for American (and Japanese) multinationals, India has not--and most of the rest of Asia falls between these two extremes.

In addition to offshore production, Asia has also emerged as an important depot for overseas distribution--the upstream buying and downstream selling of both goods and services. Here, again, both American and Japanese multinationals have much in common. For both, offshore production exceeds overseas distribution in Asia. But for the Americans, Asia represents the one region where overseas distribution is not dwarfed by offshore production--while for the Japanese, Asia is the one region where offshore production actually exceeds overseas distribution. And for both, Hong Kong is a major distribution center, given the concentration there of FDI in wholesaling and other trade-related services. As a result of that U.S. FDI, for example, U.S. wholesalers in Hong Kong report foreign sales over twice as large as U.S. manufacturers report there.<sup>62</sup> A decade earlier, in 1982, Singapore could also claim to be a distribution center for American multinationals, given the rough parity in sales there between overseas distribution and offshore production;<sup>63</sup> but by 1992 sales by U.S. distributors were barely one-third the size of sales by U.S. manufacturers.<sup>64</sup> In both Hong and Singapore, then, we see the recent effects of economic specialization, emphasizing in these two cases either offshore manufacturing or overseas distribution.

Such specialization, of course, is not limited to countries, but is also visible at the company level, where dedicated trading companies may differentiate themselves from more traditional manufacturers. Among the Japanese, for example, we have already seen that *sogo shosha* have often teamed up with textile manufacturers to form joint ventures in Asia. In all of these joint ventures, Japanese trading companies considered their Asian investments as growing markets for trade arbitrage, principally serving as purchasing agents authorized to buy commodities upstream, but also serving as marketing agents authorized to sell commodities downstream.<sup>65</sup> However, the same relationship did not hold in electronics, automobiles, and several other industries

where, as we have also noted, *sogo shosha* did not prove crucial to Japanese FDI in Asia.<sup>66</sup> Outside of textiles, then, Japanese manufacturers often established dedicated sales channels and after-sales service networks to aid their overseas distribution of goods produced at home and abroad.

By investing aggressively in overseas distribution, Japanese multinationals are following a strategy they have long pursued back in Japan, where they tightly control their own proprietary distribution systems.<sup>67</sup> Such control over distribution channels has severely constrained foreigners' access to the Japanese market.<sup>68</sup> Seeking to overcome such entry barriers in Japan, American (and European) multinationals have aggressively invested in majority subsidiaries engaged principally in Japanese distribution; in this way, they have pursued an unusual strategy, one without parallel for Americans operating in other industrialized countries (see Table 5).

By contrast, in these more advanced markets, overseas distribution has been far more central than offshore production to the foreign-investment strategies of Japanese multinationals, certainly when compared to their American counterparts (see Table 5). In both North America and Western Europe--but not in Asia--foreign sales by Japanese-owned wholesalers are between two and three times larger than the foreign sales of Japanese-owned manufacturers. By contrast, in all three of these regions, majority U.S.-owned manufacturers report foreign sales larger than those generated by majority U.S.-owned distributors. Indeed, in North America and Western Europe, these U.S. manufacturers sell three to five times more than do U.S. distributors also operating there. So, in marked contrast to the Americans, Japanese multinationals have invested far more aggressively in wholesaling subsidiaries in order to lower the transaction and information costs associated with upstream purchasing and downstream marketing.

Far more like the Japanese were the Koreans, who generated eight times more U.S. sales during 1992 through their direct investments in U.S. wholesaling than through their FDI in U.S. manufacturing--far in excess of other Asian multinationals

(see Table 5). To generate these sales, nearly one-half of all Korean FDI in the United States is invested in U.S. retail and wholesale trade, far more than the one-fifth invested in manufacturing. Similarly, in Japan, retail and wholesale trade is the second largest category (falling well behind real estate) of otherwise limited Korean investments there, well ahead of minuscule investments in Japanese manufacturing.<sup>69</sup> By contrast, elsewhere in Asia, Korean manufacturing investments dwarf those in retail and wholesale trade, in a sharp departure from Japanese strategy across that region. In short, the striking similarities evidenced by both Japanese and Korean multinationals operating in the United States do not carry over to Asia.

### **Markets: Local vs. Export Markets**

In general, foreign sales come from three sources: the host-country market of the foreign subsidiary, the home-country market of that subsidiary's parent, and third-country markets that are typically in close geographic proximity to the host country. Choices among these three are determined by a wide range of variables, including the following: market size and growth prospects, as well as market access resulting from government policies and competitor behavior. Given these relative weightings, as a practical matter, multinational corporations typically generate most of their foreign sales in the local market or one of two export markets (either back home or in third countries), but seldom spread equally between two or among all three. Indeed, until quite recently, multinationals have long focused almost exclusively on the local market hosting their foreign direct investments.

For the Americans, at least during the 1950s and 1960s, these local markets accounted for three-quarters of all foreign sales generated abroad by majority U.S. subsidiaries.<sup>70</sup> Subsequently, beginning in the late 1970s and continuing through the 1980s, that share gradually declined,<sup>71</sup> so that it reached two-thirds of total foreign sales worldwide by 1992 (see Table 6). That same year, Japanese multinationals

worldwide also reported a comparable sales contribution by local host-country markets (see Table 6). As with the Americans, so too with the Japanese, such a contribution had also declined over the last two decades; in the early 1970s, for example, local markets also contributed three-quarters of total foreign sales by Japanese subsidiaries abroad.<sup>72</sup> Thus, for both the Americans and the Japanese, local markets hosting their FDI remain the principal sources of multinational sales globally. And they have reached this comparable outcome by again evolving in a common direction, marked this time by a general decline in the relative importance of local markets to generate foreign sales.

-- INSERT TABLE 6 HERE --

Of course, the relative importance of the host-country market in generating a multinational's foreign sales varies widely across countries and regions. On one extreme are the United States and Japan. For example, European and Japanese multinationals both reported in 1992 that the local U.S. market consumed well over 85 percent of their subsidiaries' total U.S. sales.<sup>73</sup> Consequently, exports back home and to third countries have remained quite small. Similarly, in Japan, American subsidiaries sold nearly 90 percent of their goods and services in the local market (see Table 6)--a figure comparable to the local sales also generated there by European multinationals.<sup>74</sup> In short, the sheer size of the world's two largest markets continues to exert a powerful and common influence on the investment strategies of American, European, and Japanese multinationals.

In contrast to the United States and Japan, Western Europe offers both American and Japanese multinationals greater opportunities to generate sales not only in the local market hosting their investments, but also in so-called third-country markets, typically located in close geographic proximity to the host country. Thanks in large part to the European Union, exports to third countries contributed roughly one-third of the

**TABLE 6: THE DESTINATION OF FOREIGN SALES, 1992****AMERICAN MULTINATIONALS ABROAD, ALL INDUSTRIES, 1992<sup>a</sup>**

Sales	North	Western			
<u>Destination:</u>	<u>America</u>	<u>Europe</u>	<u>Japan</u>	<u>Other Asia</u>	
\$ billion	\$1,298.5	\$205.2	\$765	\$72.1	\$100.6
<u>of which, %</u>					
Local	65.9%	71.3%	64.0%	89.0%	51.7%
Back to US	10.1%	25.9%	3.8%	4.7%	19.5%
3d Markets	24.0%	2.8%	32.2%	6.3%	28.8%

**AMERICAN MULTINATIONALS ABROAD, MANUFACTURING ONLY, 1992<sup>a</sup>**

Sales	North	Western			Other	Asia
<u>Destination:</u>	<u>America</u>	<u>Europe</u>	<u>Japan</u>	<u>Manufacturing</u>	<u>Electronics Only</u>	
\$ billion	\$629.6	\$120.5	\$387.4	\$28.4	\$36.6	\$13.0
<u>of which, %</u>						
Local	58.7%	59.5%	55.5%	84.2%	37.4%	23.8%
Back to US	12.3%	37.1%	3.7%	7.4%	35.0%	47.7%
3d Markets	29.0%	3.4%	40.8%	8.4%	27.6%	28.5%

**AMERICAN MULTINATIONALS ABROAD, WHOLESALING ONLY, 1992<sup>a</sup>**

Sales	North	Western			
<u>Destination:</u>	<u>America</u>	<u>Europe</u>	<u>Japan</u>	<u>Other Asia</u>	
\$ billion	\$242.2	\$22.8	\$160.6	\$19.5	\$21.8
<u>of which, %</u>					
Local	71.1%	88.2%	69.2%	88.2%	49.5%
Back to US	4.3%	7.0%	2.1%	4.6%	17.9%
3d Markets	24.6%	4.8%	28.7%	7.2%	32.6%

**JAPANESE MULTINATIONALS ABROAD, ALL INDUSTRIES, 1992**

Sales:	North	Western		
<u>Worldwide</u>	<u>America</u>	<u>Europe</u>	<u>East Asia</u>	
\$ billion	\$633.2	\$268.8	\$178.7	\$124.7
<u>of which, %</u>				
Local	66.3%	78.4%	54.8%	59.4%
Japan	14.5%	12.6%	8.4%	21.8%
3d Markets	19.2%	9.0%	36.8%	18.8%

**JAPANESE MULTINATIONALS ABROAD, MANUFACTURING ONLY, 1992**

Sales:	North	Western	Other	Asia
<u>Worldwide</u>	<u>America</u>	<u>Europe</u>	<u>Manufacturing</u>	<u>Electronics Only</u>
\$ billion	\$201.3	\$80.7	\$42.1	\$63.7
<u>of which, %</u>				
Local	76.7%	91.9%	55.7%	66.1%
Japan	6.3%	2.8%	1.2%	15.8%
3d Markets	17.0%	5.3%	43.1%	18.1%
				27.2%
				27.1%

**JAPANESE MULTINATIONALS ABROAD, WHOLESALING ONLY, 1992**

Sales:	North	Western		
<u>Worldwide</u>	<u>America</u>	<u>Europe</u>	<u>Asia</u>	
\$ billion	\$391.0	\$173.4	\$129.7	\$54.8
<u>of which, %</u>				
Local	60.3%	70.8%	54.4%	47.9%
Japan	19.4%	18.0%	11.6%	31.2%
3d Markets	20.3%	11.2%	33.0%	20.9%

**TABLE 6** (continued)

Notes: <sup>a</sup>Data for majority U.S.-owned subsidiaries only.

Source: US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1992 Estimates (Washington: USGPO, September 1992), Table III.F.2, n.p.; Foreign Direct Investment in the United States: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Tables G-2 and G-24, n.p.; Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The Fifth Comprehensive Survey of Foreign Investment Statistics [*Dai go-kai wagakuni kigyo no kaigai jigyo katsudo*]. (Tokyo: MITI, 1994), Table 2-25, pp. 188-199.

total Western European sales recorded by both American and Japanese multinationals operating there (see Table 6). Those shares were higher still in manufacturing, where third-country exports mostly to other EC members contributed nearly comparable shares--40 percent--of the total European sales recorded by American and Japanese multinationals engaged in production there. For both, such a percentage is well above their global averages: U.S. manufacturing subsidiaries sold just over one-quarter of their total foreign sales in third-country markets, compared to one-sixth or so for their Japanese counterparts. Thus, the common pressures of regional integration are having a similar impact on both American and Japanese multinationals, and that impact varies across regions as well as across industrial sectors.

But these same pressures are having a different impact in both North America and Asia. In North America, third-country sales by both American and Japanese multinationals remain small, especially in manufacturing. But in Asia, American multinationals lead the way in promoting intraregional trade. In both manufacturing and wholesaling, these third-country sales contributed nearly 30 percent of the total revenues generated across Asia by U.S. subsidiaries, well above comparable shares (less than 20 percent) generated by all Japanese subsidiaries operating in that region (see Table 6). So, while American and Japanese multinationals are following comparable export strategies regarding third-country markets in Western Europe and North America, the same cannot be said in Asia.

In addition to third-country exports, Asia also provides these multinationals with sizable--yet different--opportunities to export back to their home markets (see Table 6). Indeed, when combined across industries, both American and Japanese multinationals during 1992 generated roughly one-fifth of their total Asian sales through exports back home. For the Japanese, this share is well above comparable sales generated by home-bound exports from their subsidiaries elsewhere in the world; whereas for the Americans, this share is just below comparable sales for their

subsidiaries operating closer to home, in Canada and Mexico. As this comparison suggests, geography matters, with distance from the home country an important determinant of FDI-related trade.

But in Asia, the importance of the home country as an export market varies widely across industries, and between multinationals (see Table 6). For the Japanese, most of these home-bound shipments come from Asian subsidiaries engaged in the wholesale trade of local purchases exported to Japan; these Japanese-owned wholesalers accounted for twice as many exports to Japan as did Japanese manufacturing subsidiaries in Asia. For the Americans, by contrast, most home-bound shipments come from majority subsidiaries engaged in Asian manufacturing: These U.S. manufacturing subsidiaries generated 35 percent of their total Asian sales from exports back to the U.S. market. This share is roughly comparable to that generated by U.S. manufacturing subsidiaries in both Canada and Mexico, and is well over twice the share generated through exports back home by Japanese manufacturers operating in Asia. Once again, we see that American and Japanese manufacturers in Asia are following different export strategies, this time with regard to their home markets.

No where is the difference in market orientation between American and Japanese multinationals more apparent than in the manufacture of electronics (see Table 6). In this industry, an American preoccupation with export markets back home has been matched by a Japanese preoccupation with the local host-country market. In fact, shipments back home to the United States accounted for nearly one-half of the total sales reported in 1992 by U.S. electronics subsidiaries in Asia, while their Japanese counterparts generated a roughly comparable share of their total sales in the local host-country market. In a similar juxtaposition, these same Japanese electronics subsidiaries in Asia generated roughly one-quarter of their 1992 sales from exports back home--nearly the same share generated by their U.S. counterparts from sales in the local host-country market. Only in shipments to third-country markets,

principally located elsewhere in Asia, did American and Japanese electronics manufacturers in Asia follow a common trade strategy, and thus generate comparable shares of their total sales.

More generally, then, Japanese multinationals in Asia are far more interested in the local market hosting their FDI than in exporting either to their home or to third-country markets. For example, Japanese manufacturing subsidiaries in Asia generated fully two-thirds of their 1992 sales in the host-country market --nearly twice the comparable share recorded by American manufacturers. Indeed, for the Americans, the last time local markets generated such a sizable share of their Asia sales was nearly three decades earlier when, in 1966, their majority subsidiaries reported that host-country markets contributed fully three-quarters of their Asian sales.<sup>75</sup> For the Americans at least, that earlier attention to local markets was a response to the import-substituting policies operating then across Asia.

But with the subsequent liberalization of these policies, and the movement toward more outward-oriented policies, Asia illustrates some of the most rapid decline in the relative importance of host-country markets in generating sales, especially for American multinationals. In fact, by 1977, the sales contribution of the local market in Asia had declined significantly, reaching two-fifths of total Asian sales; nearly as much was now being exported to the United States, with the remainder shipped to third-country markets.<sup>76</sup> By comparison, that same year, Japanese multinationals sold much less outside of the local market hosting their Asian investments. In fact, during 1977, that local host-country market accounted for fully three-fifths of total foreign sales generated by all Japanese multinationals in Asia.<sup>77</sup> Thus, for both the Americans and the Japanese, sharp differences in export strategies visible as early as 1977 were only accentuated by 1992.

The conclusion that American multinationals generate a greater proportion of their subsidiaries' sales in Asia from export markets strongly contradicts a popular

argument advanced by at least one important school of Japanese scholars. These scholars have long argued that Japanese multinationals pursue investment strategies that are far more trade-enhancing than those favored by American multinationals.<sup>78</sup> For relevant data, these scholars focus on the 1970s and 1980s, and especially on Asia, the only region where both American and Japanese multinationals can claim long histories of direct investment. Yet, when we combine exports back home with exports to third countries, we come to a very different conclusion: For the last two decades, Japanese multinationals have been less reliant on international trade to generate their foreign subsidiaries' sales in Asia than have American multinationals.

### **Trade: Intracompany Shipments vs. Arm's-Length**

Much of the trade conducted by multinational corporations is shipped intracompany, among and between parents and their subsidiaries--a fact that has recently attracted the renewed attention of academic scholars.<sup>79</sup> For multinationals, such hierarchical trade insures greater control over both upstream supplies and downstream markets than do more arm's-length transactions among unaffiliated buyers and suppliers. Intracompany trade also substantially lowers the high costs which these arm's-length transactions normally impose on those cross-border exchanges of the technological, marketing, and organizational assets necessary to compete successfully through foreign production and overseas distribution. As we argued above, only with majority ownership do multinationals exercise sufficient managerial control to dictate their subsidiaries' decisions regarding these exchanges; such control is far more circumscribed in minority affiliates. Empirically, intracompany trade seems especially prominent in autos and other industries where significant economies can be achieved through the integration and coordination of multiplant operations; or where additional advantages can be gained through after-sales service.

On one extreme, U.S.-Japan trade illustrates the growing predominance of intracompany shipments. Here, Japanese multinationals exercise unrivaled control over the two-way flow (see Table 8). By 1992, in fact, over two-thirds of all U.S. imports from Japan and over one-half of all U.S. exports to Japan were shipped intracompany, largely between the parents of Japanese multinationals and their (principally majority) subsidiaries in the United States. Among imports, for example, the auto industry--cars, parts and components--accounted for over one-quarter of all Japanese shipments to the United States, most of which (over 80 percent) were shipped by Japanese automakers and parts suppliers directly to their U.S. subsidiaries.<sup>80</sup> Similarly, for U.S. exports to Japan, intracompany trade again predominates: Shipments from Japanese subsidiaries in the United States back to their Japanese parents account for upwards of two-thirds of all U.S. exports to Japan. Largely raw materials and agricultural products, these U.S. exports are then channeled by Japanese multinationals into their proprietary distribution channels back home. There, Japanese trading companies and manufacturers often enjoy lower information and transaction costs, as well as related advantages, than do more arm's-length U.S. exporters. For the Japanese, then, foreign direct investment has created the principal channels for two-way trade flows with the United States.

-- INSERT TABLE 8 HERE --

By contrast, American multinationals exercise no appreciable influence over U.S. bilateral trade with Japan. Here, limited U.S. FDI, and the concentration of that FDI in minority foreign-owned affiliates serves as an especially high barrier in Japan to U.S. exports. Indeed, minority affiliates typically represent poor markets for national exports, even in those host countries where affiliates' sales are relatively large. For example, during 1992, U.S. exports to minority U.S. affiliates worldwide remained

**TABLE 8**

**U.S. TRADE, BY INTRACOMPANY AND ARM'S LENGTH SHIPMENTS, ACROSS REGIONS AND COUNTRIES, 1992**

**U.S. TRADE WITH THE WORLD, 1992**

	(A)	(B)	(C)	(D)	(E)
		% by US Parents to/fm Majority US Subsidiaries <u>Worldwide</u>	% by All Foreign Affiliates in US to/from Their <u>Parents</u>	% Intracompany= <u>(B)+(C)</u>	% by All Other= Arm's-Length= <u>(100%)-(D)</u>
Direction of Trade	Total Value (US \$ billion)				
US Exports	\$448.7	22.1%	10.5%	32.6%	67.4%
US Imports	\$532.7	16.0%	25.2%	41.2%	58.8%

**U.S. TRADE WITH THE EUROPEAN COMMUNITY, 1992**

	(A)	(B)	(C)	(D)	(E)
		% by US Parents to/fm Majority US Subsidiaries in <u>the EC</u>	% by EC Affiliates in US to/from Their <u>Parents</u>	% Intracompany= <u>(B)+(C)</u>	% by All Other= Arm's-Length= <u>(100%)-(D)</u>
Direction of Trade	Total Value (US \$ billion)				
US Exports	\$122.6	26.3%	8.4%	34.7%	65.3%
US Imports	\$110.7	11.8%	34.2%	46.0%	54.0%

**U.S. TRADE WITH JAPAN, 1992**

	(A)	(B)	(C)	(D)	(E)
		% by US Parents to/fm Majority US Subsidiaries in <u>Japan</u>	% by Japanese Affiliates in US to/from Their <u>Parents</u>	% Intracompany= <u>(B)+(C)</u>	% by All Other= Arm's-Length= <u>(100%)-(D)</u>
Direction of Trade	Total Value (US \$ billion)				
US Exports	\$47.8	15.5%	52.7%	68.2%	31.8%
US Imports	\$97.4	2.1%	67.7%	69.7%	30.3%

**U.S. TRADE WITH ASIA (OUTSIDE JAPAN), 1992**

	(A)	(B)	(C)	(D)	(E)
		% by US Parents to/fm Majority US Subsidiaries in <u>Asia</u>	% by Asian Affiliates in US to/from Their <u>Parents</u>	% Intracompany= <u>(B)+(C)</u>	% by All Other= Arm's-Length= <u>(100%)-(D)</u>
Direction of Trade	Total Value (US \$ billion)				
US Exports	\$90.5	9.3%	5.6%	14.9%	85.1%
US Imports	\$135.7	11.1%	6.8%	17.3%	82.2%

Sources: US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1992 Estimates (Washington: USGPO, June 1994), Table III.H.1, n.p.; and Foreign Direct Investment in the United States: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Table G-2, n.p.; and International Trade Administration, Office of Trade and Investment Analysis, US Foreign Trade Highlights: 1993 (Washington, DC: USGPO, July 1994), Tables 6 and 7, pp. 17-24.

**TABLE 9**

**THE RELATIVE CONTRIBUTION OF MULTINATIONALS TO ASIAN EXPORTS, LATE 1980s TO EARLY 1990s**

	<u>All Industries</u> (% of total exports)	<u>Electronics Only</u> (% of total exports)
<u>Four NIEs</u>		
Korea (1986)	26.1%	NA
Taiwan (1986)	17.8%	30.8%
Hong Kong	NA	NA
Singapore (1989)	86.1%	NA
<u>ASEAN Four</u>		
Thailand (1990)	33.0% <sup>a,b</sup>	82.0% <sup>b</sup>
Malaysia (1991)	57.1%	82.5% <sup>a</sup>
Indonesia (1992)	32.0% <sup>a</sup>	76.0%
Philippines	NA	NA
<u>Big Two</u>		
India (1991)	9.1%	NA
China (1994)	36.1%	NA

Notes:

<sup>a</sup>Manufacturing only.

<sup>b</sup>Government-promoted firms only.

Source: Compiled from various sources in Dennis J. Encarnation, "Integrating Asia: Multinationals and the Private Management of Regionalization" (forthcoming, 1996)

negligible--accounting for only 6 percent of all U.S. exports to U.S. multinationals abroad--even though minority affiliates contributed just under 20 percent of all U.S. multinational sales.<sup>81</sup> More specifically, in Japan, U.S. exports to minority U.S. affiliates during 1992 barely totaled \$2.5 billion, much less than the \$7 billion of U.S. exports shipped that same year to majority U.S. subsidiaries in Japan.<sup>82</sup> Yet, these majority subsidiaries accounted for barely \$72 billion of sales in Japan, well below the \$90 billion in Japanese sales recorded by minority U.S. affiliates (calculated from Table 8 above).

In short, because Japan has long hosted a disproportionately large share of minority U.S. affiliates, and because these affiliates generally refrain from purchasing U.S. exports, American multinationals in Japan have contributed a relatively small share of this bilateral trade. By contrast, for the Japanese, the higher incidence of majority subsidiaries in the United States actually has granted Japanese exports far greater access to the U.S. market than the Americans, through their limited investments concentrated in minority affiliates, have been able to secure in Japan.

In marked contrast to U.S.-Japan trade, U.S.-EC trade remains far more symmetrical--as do U.S.-EC investment flows--permitting neither American nor European multinationals to dominate these bilateral flows. As a result of these multinationals, in fact, intracompany trade contributed over two-fifths of all U.S. imports from the EC (see Table 8). Here again, autos figure prominently: They comprise the largest class of traded goods (accounting for 16 percent of U.S. imports from the EC), of which nearly 90 percent are shipped intracompany, by BMW and other EC automakers to their majority subsidiaries in the United States.<sup>83</sup> Indeed, as a general rule, the parents of EC multinationals are the largest suppliers of U.S. imports from Europe, with their (largely majority) subsidiaries in the United States the largest buyers.

Conversely, looking at U.S. exports to the EC, the parents of U.S. multinationals are the largest contributors, often through intracompany shipments to their majority subsidiaries in the EC. In such trade, U.S. auto exports remain small since U.S. automakers manufacture in the EC most of what they sell there, in the absence of much auto trade, then, intracompany shipments to the EC accounted for just over one-third of all U.S. exports to the EC (see Table 8). Finally, what remains of U.S.-EC trade is shipped at arm's-length, between unaffiliated exporters and importers. Such trade accounted for well over two-thirds of all U.S. exports to Europe, and over one-half of all U.S. imports from Europe (see Table 8). Here again, MNCs play a prominent role; for example, the U.S. parents of American multinationals are major exporters to unaffiliated EC buyers, accounting for a full one-third of all U.S. exports to Europe.<sup>84</sup> In each of these ways, then, U.S.-EC trade more closely mimics U.S. trade with the world as whole, in its relative mix of intracompany and arm's length trade (see Table 8).

If U.S.-EC trade more closely approximates average U.S. trade, with U.S.-Japan trade on one extreme dominated by intracompany shipments, then U.S. trade with the rest of Asia is on an opposite extreme, dominated by more arm's-length transactions. Such transactions, in fact, accounted during 1992 for well over four-fifths of all U.S. exports to, and all U.S. imports from, Asia (outside Japan). For sure, American multinationals did play a role in that trade; for example, through shipments to unaffiliated buyers, their U.S. parents shipped roughly one-quarter of all U.S. exports to Asia.<sup>85</sup> In addition, intracompany shipments between these U.S. parents and their Asian subsidiaries contributed another 10 percent to bilateral trade flows (see Table 8). That limited contribution reflects the fact that during 1992 Asia outside Japan continued to account for a smaller proportion of all U.S. FDI (stocks) abroad than did, say, Western Europe.

Moreover, even within Asia, only a very few countries attracted U.S. FDI, especially investments in majority U.S. subsidiaries. Singapore, as we have already,

ranks among the two largest hosts to U.S. FDI in Asia (outside Japan). And as a result, in U.S. trade with Singapore, intracompany trade within American multinationals accounted for well over one-quarter of all U.S. exports, and nearly three-fifths of all U.S. imports. By contrast, Korea has long restricted FDI inflows, especially in majority foreign-owned subsidiaries. And as a result, in U.S. trade with Korea, shipments between the parents and subsidiaries of American multinationals accounted for less than 2 percent of all U.S. exports, and barely 4 percent of all U.S. imports. What remaining impact American multinationals had on U.S.-Korea trade was principally through shipments between US parents and unaffiliated Korean buyers; for example, these arm's-length shipments accounted for nearly two-fifths of all US exports to Korea.<sup>86</sup> This paucity of US intracompany trade, and the greater reliance by American multinationals on more arm's-length transactions, is reminiscent of US trade with Japan: In Korea, as in Japan, limited U.S. FDI concentrated in minority US-owned affiliates helps to account for this absence of U.S. intracompany trade.

Similarly, limited Asian FDI in the United States has also constrained intracompany trade between the parents and subsidiaries of Asian multinationals (see Table 8). Only Korean multinationals have employed their limited FDI to exercise a disproportionate influence over their country's trade with the United States. For example, intracompany shipments between the parents and (largely majority -owned) subsidiaries of Korean multinationals during 1992 exceeded one-quarter for all US imports from Korea. This share was nearly equal to the average contribution of intracompany trade by foreign multinationals to all US imports; and it was three times larger than Asian multinationals generally contributed to U.S. imports from the region (see Table 8). Even for US exports to Korea, the relative contribution of intracompany shipments by Korean multinationals again exceeds that recorded by other Asian multinationals: During 1992, Korean subsidiaries in the United States shipped nearly one-tenth of all US exports back to their Korean parents. This share was twice the

relative contribution recorded by shipments between American multinational parents and their majority subsidiaries in Korea; and it equaled the average contribution of intracompany trade by European multinationals to US exports to Europe. Outside of Korea, however, the absence of significant two-way FDI flows between the United States and Asia (outside Japan) limits most intracompany transactions, leaving arm's-length trade to predominate.

Similarly, Japan's trade with the rest of Asia is dominated by arm's-length shipments. Nevertheless, during 1992, intracompany trade between the parents and subsidiaries of Japanese multinationals contributed over 15 percent of all Japanese exports to the region, and nearly 23 percent of all Japanese imports--roughly twice comparable levels of intracompany trade recorded by American multinationals. Thus, in Asia, as in the rest of the world, Japanese multinationals continue to exercise a greater influence over their country's bilateral trade than do American multinationals.

### **IMPLICATIONS FOR CORPORATE STRATEGY AND GOVERNMENT POLICY**

Just as FDI has become integral to the Asian operations of multinational corporations (MNCs), so too that FDI has also become critical to economic performance and, consequently, government policy across Asia. Of particular concern here is the complementarity between FDI and trade visible at both the micro-level of multinational corporations and the macro-level of host economies. For both multinationals and their hosts, wide variation persists in this FDI-trade nexus, and that variation can be explained in part by persistent differences in government policy across Asia, and in part by persistent differences among multinationals operating from different home bases.

## **Corporate Strategy**

What emerges from our comparative analysis of multinational corporations are two models of foreign investment and related trade: a trans-Atlantic model evidenced in the strategies and structures pursued by both American and European multinationals, and a trans-Pacific model evidenced in the strategies and structures pursued by Japanese, Korean, and other Asian multinationals. Distinguishing these two models are persistent differences in the relationship between foreign investment and international trade. Namely, compared to American and European multinationals, Japanese and other Asian multinationals still sell more of their output in the host-country market than they do through exports to markets back home or in third countries; they continue to source more of their inputs from back home than from local or other third-country suppliers; and they more aggressively control this two-way trade of outputs and inputs through intracompany shipments linking multinational parents and their foreign subsidiaries. These persistent differences cannot be dismissed easily as mere "vintage effects," vestigial remnants reflecting various stages in a multinational's evolution, since they persist over time. Nor can they be dismissed as the result of wide variation in the sectoral distribution or geographic location of these multinationals, such these differences persist in the same industrial sector and host economy. Rather, the persistence of these differences reflects important variation in the strategies and structures pursued by multinational corporations based in different countries.

While sharp variation in the complex relationship between FDI and trade confirm the persistence of important differences among multinationals, other operational characteristics suggest a greater convergence in regional operations--as American, European, Japanese, and other Asian multinationals continue to move along an otherwise common evolutionary path. First, they all increasingly invest overseas in majority subsidiaries, all the more so when their investments are unimpeded by capital controls in the host country, and when their investments move down the value-added chain from

extraction to manufacturing to wholesaling. Second, through these majority subsidiaries, they increasingly generate a greater proportion of their foreign sales through direct investments in markets overseas, and not just through international trade unassisted by any such investments. Third, both to assist trade and to generate additional foreign sales, they all invest offshore in majority subsidiaries engaged in some combination of wholesaling and production, with the latter becoming an increasingly important source of supply.

Fourth, with these new sources of supply, American, European, Japanese, and other Asian multinationals all employ foreign subsidiaries to supply local markets hosting their direct investments, as well as to supply export markets either back home or in third countries. Fifth and finally, they all employ their foreign subsidiaries both as internal markets for exported products and as internal sources of imported supplies, linked to their parents back home (and to related subsidiaries elsewhere abroad) through intracompany trade. While American multinationals pioneered many of these investment and trade strategies immediately after World War II, they were later followed to varying degrees by the Europeans (especially during the 1970s), then the Japanese (especially during the 1980s), and now the Koreans, Chinese, and other Asians (during the 1990s). In short, several of the foreign operations of multinationals originating in different geographic locations have begun to converge, as they all move along an otherwise common evolutionary path.

At times, that convergence has been even more pronounced in Asia than elsewhere in the world, as demonstrated by the common geographic and industrial concentration of FDI from various sources. More often, MNCs in Asia more closely mimic patterns of convergence apparent elsewhere, as they do in the pursuit of majority shareholdings and FDI-generated sales. Yet important differences in MNC operations persist, even in the same host economy and industrial sector. In home-country sourcing and intra-firm trade, for example, MNCs in Asia differ much like they do elsewhere in the world. Such

differences may even be more pronounced in Asia than elsewhere, as demonstrated by wide variation in host-market and export sales. When totaled, then, those operational differences that remain are largely limited to the relationship between FDI and trade: on export markets for outputs, on imported sources of inputs, and on the organization of this two-way trade either through markets (arm's -length transactions) or hierarchies (intra-firm transactions).

### **Government Policy**

Just as the relationship between FDI and trade varies significantly among multinational corporations, so too that relationship also varies across host economies. With the total value of an economy's exports and imports bounded by savings rates and other macro-level determinants, FDI can nevertheless contribute proportionately to that trade, while also altering its composition and direction--not only for individual multinationals, but also for host (and home) economies. Simultaneously, such trade can have a significant impact on the value, direction, and composition of FDI, again at both the micro-level of multinationals and the macro-level of national economies. These complementarities between FDI and trade have recently attracted much attention.<sup>87</sup> And they have important policy implications: Trade and FDI regimes shape a multinational subsidiary's contribution to a host country's exports and imports.

Consider the relative contribution of multinational subsidiaries to Asian exports. Among the region's ten largest economies, that export contribution ranges from a high that approaches 90 percent in Singapore to a low that remains under 10 percent in India (see Table 9). These two extremes cannot be explained simply in terms of obvious differences in domestic market size. To the contrary, in marked contrast to India, China reports that foreign-affiliated firms have come to contribute well over one-third of total national exports in 1994, up from practically zero a decade earlier. That one-third, moreover, was comparable to relative shares reported in quite different

economies, such as Indonesia and Thailand. Indeed, across southeast Asia, multinationals have emerged as major exporters, contributing over one-half of national exports not only in Singapore, but also in Malaysia. (So large is the value both of these exports and of domestic value-added that, in Malaysia at least, multinationals export far more than they import.<sup>88</sup>) In north Asia, by contrast, the export contribution of multinationals is much smaller, as we can see in both Taiwan and Korea. What distinguishes these two Asian NIEs from Singapore is a combination of government policies that simultaneously limit FDI (especially in Korea) while encouraging domestic producers.

-- INSERT TABLE 9 HERE --

Just as FDI can contribute proportionately to the value of trade, so too it can also shape the composition of that trade. Nowhere is this more apparent than in the electronics industry, which (as we noted above) has attracted considerable FDI from American, Japanese, Korean, Taiwanese, and other regional electronics producers. Much of that FDI is concentrated in southeast Asia, where (as we also noted above) it is primarily export-oriented. In the near-absence of corresponding exports by domestically-owned electronics manufacturers, we find that multinationals contribute upwards of three-quarters of all electronics exports from Thailand, Malaysia, Singapore, and Indonesia (see Table 9). Thus, across these ASEAN economies, FDI by multinationals has helped to change the composition of manufactured exports to include electronics. By contrast, in Taiwan, a thriving electronics industry populated largely by domestically-owned producers results in a much lower contribution by multinationals to electronics exports. Yet, even in Taiwan, that foreign contribution to the economy's exports is higher in the electronics industry than in most other industrial sectors, further testimony to the continuing importance of FDI in helping to determine the composition of an economy's trade.

Finally, FDI can also influence the direction of trade by facilitating access to output markets and supply sources, especially those in industrialized countries. This seems especially true in Japan, where market access has long been limited for foreign exporters unaffiliated with Japanese manufacturers and distributors. No where is this more apparent than in bilateral U.S.-Japan trade. Here, Japanese-owned subsidiaries contribute well over one-half of all U.S. exports to Japan and account for well over two-thirds of all US imports from Japan--nearly all shipped intracompany, between these subsidiaries and their Japanese parents. By comparison, Japanese subsidiaries in Asia still exercise less hierarchical control over bilateral trade between their Asian hosts and Japan. While the reasons for this are multiple, one stands out: Japanese multinationals in Asia have been far more reluctant than their American counterparts to export large proportions of their Asian output back home (or to third countries), preferring instead to sell in the local host-country market. By contrast, Japanese multinationals in Asia have been much less reluctant than the Americans to rely on their home-based suppliers as principal sources of their Asian inputs. In this way, multinationals reinforce the prevailing structure of Asian trade, in which the United States remains the principal export market and Japan remains the principal source of imported supplies.

These persistent differences in corporate strategy continue to pose challenges for government policymakers across Asia. To illustrate one such challenge: With export revenues denominated principally in U.S. dollars and import costs (not to mention the foreign debt often incurred to finance these imports) denominated in large part by Japanese yen, government policymakers must manage exchange-rate risks quite similar to those faced by global managers of multinational corporations. One response, for policymaker and manager alike, is to try to match revenues and costs in the same currency. This could be accomplished, for example, through the diversification of markets, suppliers, and products (both outputs and inputs), with a corresponding

redirection of two-way trade and resultant shifts in the relative value of bilateral flows. But as this paper documents, such a structural adjustment in Asian trade will be difficult to accomplish without a corresponding impact on FDI. For as we have seen, sharp differences can still be discerned between multinationals in their determination of markets for outputs, sources for inputs, and the organization of that trade between markets (arm's-length transactions) and hierarchies (intra-firm transactions). These institutional factors, bounded by more macroeconomic determinants, shape the relative complementarities between trade and FDI.

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- <sup>1</sup> World Bank estimates, May 1995, summarized in Table 2 below.
- <sup>2</sup> UNCTC.
- <sup>3</sup> Wilkins, 1986, Tables 1-2, p. 209 and note 41, p. 217.
- <sup>4</sup> United States, Department of Commerce, 1960, Table 3, p. 92.
- <sup>5</sup> For citations, see Appendix A.
- <sup>6</sup> United States, Department of Commerce, 1960, Table 3, p. 92.
- <sup>7</sup> United States, Department of Commerce, 1994, Table 3, p. 63; 1986, Table 1, pp. 1-5; 1982, Table 1, pp. 1-27.
- <sup>8</sup> For historical data, see Appendix B.
- <sup>9</sup> United States, Department of Commerce, 1994, Table 3, p. 63; 1986, Table 1, pp. 1-5; 1982, Table 1, pp. 1-27..
- <sup>10</sup> For citations see Table 1.
- <sup>11</sup> See Appendix A.
- <sup>12</sup> United Nations Conference on Trade and Development (UNCTAD), Division of Transnational Corporations and Investment, "Foreign Direct Investment in Asia and the Pacific," Document number TD/B/ITNC/3, 24 April 1995, esp. pp. 7-11.
- <sup>13</sup> Bank of Korea, Foreign Exchange Department, Overseas Direct Investment Statistics Yearbook: 1994 (Seoul: BOK, 1994).
- <sup>14</sup> International Monetary Fund, Direction of Trade Statistics Yearbook: 1993 (Washington, DC: IMF, 1993), pp. 247-249.
- <sup>15</sup> IMF, Direction of Trade Statistics: 1993, pp. 247-249.
- <sup>16</sup> For the United States, see U.S. Commerce Department, International Trade Administration, Office of Trade and Investment Analysis, US Foreign Trade Highlights: 1993 (Washington, DC: USGPO, July 1994) pp. 168-169.
- <sup>17</sup> Bank of Korea, Foreign Exchange Department, Overseas Direct Investment Statistics Yearbook: 1994 (Seoul: BOK, 1994), Table 4, p. 26.
- <sup>18</sup> The Hong Kong Trade Development Corporation estimates that Hong Kong accounted for 63 percent--and Taiwan, another 9 percent--of the cumulative FDI flows into China during 1979-93, the period of liberalization.

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<sup>19</sup> The US Commerce Department estimates that US FDI flows into China during 1993 barely exceeded US\$ 500 million; while Japan's Ministry of Finance reports that it approved roughly US\$ 1.7 billion of Japanese FDI in China that same year. These flows account for 3 percent and 10 percent, respectively, of all FDI flows into China. This leaves leaving some 87 percent from other sources, which presumably means Hong Kong and (to a lesser extent) Taiwan.

<sup>20</sup> According to the Bank of Thailand, for example,

<sup>21</sup> For sources, see note 3 above.

<sup>22</sup> US Commerce Department, Office of Business Economics, U.S. Business Investments in Foreign Countries: A Supplement to the Survey of Current Business (Washington: USGPO, 1960), Table 20, p. 108; hereafter cited as Commerce Department, US FDI, 1957 Survey.

<sup>23</sup> For example, during 1977, American multinationals reported to the Commerce Department that over 80 percent of their "owners' equity" resided in majority US-owned subsidiaries; see US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad, 1977 (Washington: USGPO, 1981), Table II.A.18, p. 123, and Table III.A.18, p. 242; hereafter cited as Commerce Department, US FDI, 1977 Benchmark.

<sup>24</sup> US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad, 1966: Final Data (Washington: USGPO, 1975), esp. Table J-4, p. 167, and Table L-1, p. 197; hereafter cited as Commerce Department, US FDI, 1966 Benchmark.

<sup>25</sup> This finding contradicts a long-standing consensus among Japanese scholars who have argued (incorrectly) that Japanese investors are more likely than their American counterparts to establish abroad minority-owned and equal-partnership joint ventures, occasionally with multiple Japanese partners. For sources, see note 2 above.

These earlier findings, however, may well represent a simple artifact of the specific indicator that scholars examined: the actual number of joint ventures and majority subsidiaries established by Japanese multinationals. Such a measure may overestimate the relative importance of small investments in a large number of minority-owned and equal-partnership joint ventures. Indeed, by this measure, American multinationals during 1977 (the same year examined in many of the earlier Japanese studies) proved as likely to establish minority US-owned affiliates as they did to invest in majority subsidiaries. Specifically, that year, American multinationals reported direct investments in 11.9 thousand majority US-owned subsidiaries and 11.8 thousand minority US-owned affiliates; see, Commerce Department, US FDI, 1977 Benchmark, Table D, p. 20. Moreover, even by this peculiar measure, what limited data exists for the 1970s (when this consensus among Japanese scholars began to emerge) suggests that majority subsidiaries accounted for roughly two-thirds of all projects established by Japanese multinationals, at least in East Asia, the one region most often cited by these scholars (for data, see Yoshihara, 1978, Tables 4.8 and 5.1, pp. 118, 166). And by the early 1990s, majority Japanese-owned subsidiaries accounted for three out of every four Japanese affiliates established worldwide. [apan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The Fifth Comprehensive Survey of Foreign Investment Statistics /Dai

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*go-kai wagakuni kigyo no kaigai jigyo katsudo*]. (Tokyo: MITI, 1994), Table 2-12-12, p. 147.] It therefore seems accurate to claim that by the late-1970s, and continuing into the 1990s, any earlier differences in patterns of ownership that distinguished American from Japanese subsidiaries abroad had surely withered away.

<sup>26</sup> Bank of Korea, Overseas Direct Investment Statistics, 1994, Table 7, p. 65.

<sup>27</sup> For sources, see Table 2.

<sup>28</sup> Yoshihara, 1978, Tables 4.9, 4.10, and 4.11, pp. 122-25; Wilkins, 1986, esp. pp. 208-18, 229-31.

<sup>29</sup> Yoshihara, 1978, Tables 4.8 and 5.1, pp. 118, 166, 169-70.

<sup>30</sup> For citations, see Table 2.

<sup>31</sup> Encarnation, Dislodging Multinationals.

<sup>32</sup> For citations, see Table 2.

<sup>33</sup> United States, Department of Commerce, 1981, Tables II.F.5 and III.F.5, pp. 138, 282-283.

<sup>34</sup> For Japan see Encarnation, Rivals, esp. pp. 209-212; also see Dennis J. Encarnation and Mark Mason, "Neither MITI nor America: The Political Economy of Capital Liberalization in Japan," International Organization (Winter 1990): 25-54. For Korea see, Dennis J. Encarnation, Dislodging Multinationals: India's Strategy in Comparative Perspective (Ithaca, NY: Cornell University Press, Cornell Series in Political Economy, 1989), esp. pp. 204-215..

<sup>35</sup> Yet some analysts have only recently discovered this relationship. See, for example, Susan Strange, "The Name of the Game," in Nicholas X. Rizopoulos, ed., Sea-Changes: American Foreign Policy in a World Transformed (New York: Council on Foreign Relations Press, 1991), p. 242: in the "evolution of international business ... the mid-1980s were a milestone as the volume of international production for the *first time* exceeded the volume of international trade" (emphasis added)

<sup>36</sup> For sales data, see Commerce Department, US FDI, 1957 Survey, Table 22, p. 110; for trade data, see US Commerce Department, Bureau of International Commerce, "United States Trade with Major World Areas, 1955 and 1956," Overseas Business Reports (May 1957): 2, 8.

<sup>37</sup> For sales data, see Commerce Department, US FDI, 1966 Benchmark, Table L-2, p. 198; for trade data, see US Commerce Department, Bureau of International Commerce, "United States Trade with Major World Areas, 1965 and 1966," Overseas Business Reports (May 1967): 3, 12.

<sup>38</sup> During 1977, when Japanese exports to the world totaled \$85 billion, Japanese affiliates abroad reported foreign sales of roughly \$85 billion (or ¥22.8 trillion). For sales data see, Japan, Ministry of International Trade and Industry, Industrial Policy

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Bureau, The 8th Survey of the Overseas Business Activities of Japanese Enterprises [Dai hachi-kai wagakuni kigyo no kaigai jigyo katsudo] (Tokyo: MITI, 1979), Table 51, p. 54; hereafter cited as MITI, Japanese FDI, 8th Survey. For trade data, see International Monetary Fund, International Trade Statistics Yearbook: 1980 (Washington, DC: IMF, 1981), p. 243.

39 Commerce Department, US Direct Investment Abroad: Preliminary 1992 Estimates, table III.E.3; Commerce Department, US Foreign Trade Highlights: 1992, p. 88.

40 For sources, see note 22 above.

41 For sales data, US Commerce Department, Bureau of Economic Analysis, Foreign Direct Investment in the United States, Volume 2. Report of the Secretary of Commerce, Benchmark Survey, 1974 (Washington, DC: USGPO, April 1976), Table K-5, p. 139; for trade data, see US Department of Commerce, International Trade Administration, Office of Trade and Investment Analysis, US Foreign Trade Highlights (Washington, DC: USGPO, various years).

42 US Commerce Department, Bureau of Economic Analysis, Foreign Direct Investment in the United States: 1987 Benchmark Survey, Final Results (Washington, DC: USGPO, August 1990), Table E-2, p. 76; Commerce Department, US Foreign Trade Highlights, 1991, p. 89.

43 For sources, see note 27 above.

44 Commerce Department, US Foreign Trade Highlights: 1993, Table 7, p. 22; Bank of Korea, Overseas Direct Investment Statistics: 1994, Table 4.

45 Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The 25th Survey of Business Activities of Foreign Enterprises in Japan [Dai niyugo-kai gaishikei kigyo no doko] (Tokyo: Ministry of Finance Printing Bureau, 1992), Table 24-4, p. 80; hereafter cited as MITI, FDI in Japan, 25th Survey.

46 US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (Washington, DC: USGPO, 1985), Table III.D.3, p. 215; \_\_\_\_\_, International Trade Administration, U.S. Foreign Trade Highlights: 1988 (Washington, DC: USGPO, 1985), Table V.1, pp. 82-86.

47 Dennis J. Encarnation and Mark Mason, "Neither MITI nor America: The Political Economy of Capital Liberalization in Japan," International Organization (Winter 1990), pp. 29-54.

48 Robert E. Lipsey, "Changing Patterns of International Investment in and by the United States," in Martin Feldstein, ed., The United States in the World Economy (Chicago: University of Chicago Press for the National Bureau of Economic Research, 1988), pp. 488-92; David J. Goldsborough, "Investment Trends and Prospects: The Link with Bank Lending," Theodore H. Moran, ed., Investing in Development: New Roles for Private Capital? (Washington, D.C.: Overseas Development Council, 1986).

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49 US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (Washington, DC: USGPO, 1985), Table III.D.3, p. 215; \_\_\_\_\_, International Trade Administration, U.S. Foreign Trade Highlights: 1988 (Washington, DC: USGPO, 1985), Table V.1, pp. 82-86.

50 For 1980 data see: MITI, The First Comprehensive Survey of Foreign Investment Statistics, 1983, Table II.53.3, p. 330; IMF, Direction of Trade Statistics, various years.

51 For sources, see Table 3.

52 Bank of Korea, Overseas Direct Investment Statistics: 1994, Table 5, pp. 38-39.

53 For sales data, see the following Commerce Department publications: 1957 Survey, Table 22, p. 110; US FDI, 1966 Benchmark, Table L-3, p. 199; 1977 Benchmark, Table II.H.1, p. 318; US FDI, 1988 Survey, Table 34, n.p. For trade data, see Commerce Department, "International Business Indicators," Overseas Business Reports (January 1973), Table 5, p. 14; US Foreign Trade Highlights (various years).

54 For sales data, see US Commerce Department, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1990 Estimates (Washington: USGPO, September 1992), Table III.F.2, n.p.; for trade data, see Commerce Department, US Foreign Trade Highlights: 1992, p. 88.

55 For sources, see note 26 above.

56 For sales data see, MITI, Japanese FDI, 8th Survey, Table 51, p. 54; for trade data see, IMF, Direction of Trade Statistics Yearbook: 1980, p. 242. Specifically, in the United States, 1974 estimates of Japanese manufactured exports ranged as high as ten times the value of local production.

57 MITI, FDI in Japan, 25th Survey, Table 24-4, p. 80.

58 1982 survey; 1988 DOT stats.

59 For 1992 data, see Table 4; for 1982 data, see US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (Washington, DC: USGPO, 1985), Table III.D.3, p. 215; \_\_\_\_\_, International Trade Administration, U.S. Foreign Trade Highlights: 1988 (Washington, DC: USGPO, 1985), Table V.1, pp. 82-86.

60 For 1992 data, see Table 4; for 1982 data, see MITI, The First Comprehensive Survey of Foreign Investment Statistics, 1983, Table II.53.3, p. 330; IMF, Direction of Trade Statistics, various years.

61 For sources, see Table 4.

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62 For sources, see Table 4.

63 US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (Washington, DC: USGPO, 1985), Table III.D.3, p. 215; \_\_\_\_\_, International Trade Administration, U.S. Foreign Trade Highlights: 1988 (Washington, DC: USGPO, 1985), Table V.1, pp. 82-86.

64 For citations, see Table 4.

65 According to Yoshihara (1978, pp. 124-25), writing at the height of Japanese FDI in East Asian textiles: "If investment was to establish a spinning mill, the participating trading company wanted to be its chief supplier of fiber; if it was to set up a fiber plant, the trading company wanted to be its chief supplier of chemical raw materials; if investment was to build an export base, it wanted to market the goods."

66 Again, according to Yoshihara (1978, pp. 169-70), the trading company is little involved in the marketing of electrical machinery, automobiles, and general machinery, and its overseas investment in these products is small. But in such homogenous products as textiles, iron and steel, and chemicals, whose marketing it handles, overseas investment is large. Contrary to the widely held view that the trading company is an active investor in most industries, its investment is highly selective. In the field of products which are differentiated or which require customer service, involvement as either marketer or investor tends to be small (emphasis added)..

67 For an early survey of these barriers see, Michael Yoshino, The Japanese Marketing System: Adaptations and Innovations (Cambridge, MA: MIT Press, 1971); for more recent surveys, see the following chapters in Paul Krugman, ed., The US and Japan: Trade and Investment (Cambridge, MA: MIT Press for the National Bureau of Economic Research, 1991): Itoh Motoshige, "The Japanese Distribution System and Access to the Japanese Market," and Ito Takahashi and Maruyama Masayoshi, "Is the Japanese Distribution System Really Inefficient?"

68 This subject had attracted much recent attention among scholars and policymakers; see, for example, Robert Z. Lawrence, "Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups," a paper prepared for the Brookings Panel on Economic Activity, April 4-5, 1991.

69 Bank of Korea, Overseas Direct Investment Statistics: 1994, Table 5, pp. 38-39.

70 Commerce Department, US FDI, 1957 Survey, Table 22, p. 110; Commerce Department, US FDI, 1966 Benchmark, Table L-1, p. 197.

71 Commerce Department, US FDI, 1977 Benchmark, Table II.H.1, p. 318; Commerce Department, US FDI, 1988 Survey, Table 34, n.p.; Commerce Department, US FDI, 1992 Survey, Table III.F.2, n.p.

72 For 1971, see Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, Overseas Business Activities of Japanese Enterprises: Current Situation and Problems [*Wagakuni kigyo no kaigai jigyo katsudo: sono gendai to mondaiten*] (Tokyo:

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MITI, 1973), Table 4-2-2, pp. 86-87. For 1988, see MITI, Japanese FDI, 19th Survey, pp. 82-83. For 1990, see MITI, Japanese FDI, 22nd Survey, pp. 88-89.

73 US Commerce Department, Bureau of Economic Analysis, Foreign Direct Investment in the United States: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Tables G-2 and G-24, n.p..

74 MITI, FDI in Japan, 25th Survey, Table 24-4, p. 80..

75 For historical data, see Appendix C.

76 See Appendix C.

77 For historical data, see Appendix D.

78 For sources, see note 2 above.

79 See, for example, Encarnation, Rivals beyond Trade, esp. pp. 26-31, 190-197.

80 US Commerce Department, Direction of Trade Statistics: 1992, pp. 11, 15, 79; US Commerce Department, Bureau of Economic Analysis, Foreign Direct Investment in the United States: 1987 Benchmark Survey, Final Results (Washington, DC: USGPO, August 1990), Table G-31, p. 149; hereafter cited as Commerce Department, FDI in US: 1987 Benchmark.

81 For US exports to US affiliates abroad, and overall sales data, see Commerce Department, US FDI, 1992 Survey, Tables II.E.3, II.H.5, II.H.22, III.E.3, III.H.2, n.p.; for overall US exports, see Commerce Department, US Foreign Trade Highlights: 1992, Table 2, p. 11.

82 For sources, see note 61 above.

83 Commerce Department, US Foreign Trade Highlights: 1991, pp. 15, 89; Commerce Department, FDI in US: 1987 Benchmark, Table G-31, p. 149.

84 For sources, see Table 6.

85 For sources, see Table 6.

86 For sources, see Table 6.

87 Edward M. Graham

88 See Table 7, following

TABLE 7

**HOME-COUNTRY EXPORTS TO MULTINATIONAL SUBSIDIARIES, AS A SHARE OF SUBSIDIARIES SALES, 1992**
**THE RATIO OF U.S. SUBSIDIARIES' SALES ABROAD TO U.S. EXPORTS, 1992**

Location of Subsidiaries/ Destination of Exports:	Foreign Sales by Majority US Subsidiaries Abroad (A)	US Exports to US Subsidiaries Abroad (B)	US Exports to US Subsidiaries as a % of Subsidiaries' Sales (B/A)
All Countries (\$ bil.)	\$1,298.5	\$114.1	8.8%
of which:			
North America	\$205.2	\$52.5	25.6%
European Community	\$678.7	\$32.1	4.7%
Japan	\$72.1	\$7.8	10.8%
Other Asia	\$100.6	\$9.5	9.4%

**THE RATIO OF U.S. IMPORTS TO FOREIGN AFFILIATES' SALES IN THE UNITED STATES, 1992**

National Origin of Affiliates/ Source of Imports:	US Sales by Foreign Subsidiaries in the US (A)	Home-Country Exports to Foreign Subsidiaries in the US (B)	Home-Country Exports to Foreign Subsidiaries as a % of Subsidiaries' Sales (B/A)
All Countries (\$ bil.)	\$1,222.6	\$182.2	14.9%
of which:			
Europe	\$649.8	\$41.0	6.3%
Japan	\$334.8	\$73.5	22.0%
Other Asia	\$22.5	\$12.2	54.2%

**THE RATIO OF JAPANESE EXPORTS TO JAPANESE AFFILIATES' SALES ABROAD, 1992**

Location of Affiliates/ Destination of Exports:	Foreign Sales by Japanese Affiliates Abroad (A)	Japanese Exports to Japanese Affiliates Abroad (B)	Japanese Exports to Japanese Affiliates as a % of Affiliates' Sales (B/A)
All Countries (\$ bil.)	\$633.2	\$118.3	18.6%
of which:			
North America	\$268.8	\$52.9	19.7%
European Community	\$178.7	\$33.8	18.9%
Asia	\$124.7	\$21.7	17.4%

Sources: US Commerce Department, Bureau of Economic Analysis, U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates, Preliminary 1992 Estimates (Washington: USGPO, June 1994), Table III.E.3, n.p.; Foreign Direct Investment in the United States: 1992 Benchmark Survey, Preliminary Results (Washington: USGPO, August 1994), Tables E-4 and G-30, n.p.; Japan, Ministry of International Trade and Industry, Industrial Policy Bureau, International Business Affairs Division, The Fifth Comprehensive Survey of Foreign Investment Statistics [Dai go-kai wagakuni kigyo no kaigai jigyo katsudo]. (Tokyo: MITI, 1994), Table 2-25, pp. 188-199.